

CANCER GENETICS, INC  
Form 10-Q  
August 05, 2013  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2013

Or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from            to

Commission file number 001-35817

**CANCER GENETICS, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: CANCER GENETICS, INC - Form 10-Q

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**04-3462475**  
(I.R.S. Employer  
Identification No.)

**201 Route 17 North 2<sup>nd</sup> Floor**  
**Rutherford, NJ 07070**  
**(201) 528-9200**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

As of August 5, 2013, there were 4,344,619 shares of common stock, par value \$0.0001 of Cancer Genetics, Inc. outstanding.

**Table of Contents**

**CANCER GENETICS, INC. AND SUBSIDIARIES**

**TABLE OF CONTENTS**

**PART I FINANCIAL INFORMATION**

<u>Item 1. Financial Statements (Unaudited)</u>	
<u>Consolidated Balance Sheets</u>	1
<u>Consolidated Statements of Operations</u>	2
<u>Consolidated Statements of Cash Flows</u>	4
<u>Notes to Unaudited Consolidated Financial Statements</u>	5
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	31
<u>Item 4. Controls and Procedures</u>	32

**PART II OTHER INFORMATION**

<u>Item 1. Legal Proceedings</u>	33
<u>Item 1A. Risk Factors</u>	33
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds from Sales of Registered Securities</u>	37
<u>Item 3. Defaults Upon Senior Securities</u>	37
<u>Item 4. Mine Safety Disclosures</u>	37
<u>Item 5. Other Information</u>	37
<u>Item 6. Exhibits</u>	37

<b><u>SIGNATURE</u></b>	38
-------------------------	----

<b><u>INDEX TO EXHIBITS</u></b>	39
---------------------------------	----

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)  
Cancer Genetics, Inc. and Subsidiary****Consolidated Balance Sheets**

	June 30, 2013 (Unaudited)	December 31, 2012
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,940,808	\$ 819,906
Accounts receivable, net of allowance for doubtful accounts of \$36,000	1,263,241	850,545
Other current assets	708,914	489,278
<b>Total current assets</b>	<b>3,912,963</b>	2,159,729
<b>FIXED ASSETS</b> , net of accumulated depreciation	<b>856,433</b>	964,923
<b>OTHER ASSETS</b>		
Security deposits	1,564	1,564
Restricted cash	300,000	250,000
Loan guarantee and financing fees, net of accumulated amortization of 2013 \$996,145; 2012 \$929,498	892,855	1,907,502
Patents	348,828	324,764
Deferred offering costs	142,941	3,343,289
	1,686,188	5,827,119
<b>Total Assets</b>	<b>\$ 6,455,584</b>	\$ 8,951,771
<b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued expenses	\$ 2,743,141	\$ 4,578,761
Obligations under capital leases, current portion	16,211	17,158
Deferred revenue	318,781	468,010
Notes payable, current portion	1,564,014	3,836,567
Line of credit	7,996,500	2,871,200
<b>Total current liabilities</b>	<b>12,638,647</b>	11,771,696
Obligations under capital leases		7,490
Deferred rent payable	167,543	164,298
Notes payable, long-term		2,440,683
Line of credit		6,000,000
Warrant liability	518,000	12,549,000
<b>Total liabilities</b>	<b>13,324,190</b>	32,933,167
<b>STOCKHOLDERS DEFICIT</b>		
Series A Preferred Stock, authorized 588,000 shares \$0.0001 par value (converted to common stock on April 10, 2013-Note 4), 587,691 shares issued and outstanding in 2012		59
		182

Edgar Filing: CANCER GENETICS, INC - Form 10-Q

Series B Preferred Stock, authorized 2,000,000 shares \$0.0001 par value (converted to common stock on April 10, 2013-Note 4), 1,821,600 shares issued and outstanding in 2012

Common stock, authorized 100,000,000 and 24,000,000 shares, respectively, \$0.0001 par value, 4,316,691 and 1,349,936 shares issued and outstanding as of June 30, 2013 and December 31, 2012, respectively

	432	135
Additional paid-in capital	48,864,777	24,970,255
Treasury stock		(17,442)
Accumulated deficit	(55,733,815)	(48,934,585)
<b>Total Stockholders Deficit</b>	<b>(6,868,606)</b>	<b>(23,981,396)</b>
<b>Total Liabilities and Stockholders Deficit</b>	<b>\$ 6,455,584</b>	<b>\$ 8,951,771</b>

See Notes to Unaudited Consolidated Financial Statements.

**Table of Contents****Cancer Genetics, Inc. and Subsidiary****Consolidated Statements of Operations****(Unaudited)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
<b>Revenue</b>	<b>\$ 1,831,649</b>	<b>\$ 1,148,475</b>	<b>\$ 3,050,316</b>	<b>\$ 1,983,227</b>
<b>Cost of revenues</b>	<b>1,279,274</b>	<b>1,085,633</b>	<b>2,349,294</b>	<b>1,908,685</b>
<b>Gross profit</b>	<b>552,375</b>	<b>62,842</b>	<b>701,022</b>	<b>74,542</b>
Operating expenses:				
Research and development	<b>455,570</b>	<b>526,730</b>	<b>950,597</b>	<b>1,050,241</b>
Sales and marketing	<b>446,468</b>	<b>376,281</b>	<b>831,955</b>	<b>715,849</b>
General and administrative	<b>1,384,123</b>	<b>1,393,495</b>	<b>2,961,374</b>	<b>2,329,652</b>
<b>Total operating expenses</b>	<b>2,286,161</b>	<b>2,296,506</b>	<b>4,743,926</b>	<b>4,095,742</b>
<b>Loss from operations</b>	<b>(1,733,786)</b>	<b>(2,233,664)</b>	<b>(4,042,904)</b>	<b>(4,021,200)</b>
Other (expense) income:				
Interest expense	<b>(389,319)</b>	<b>(1,082,797)</b>	<b>(1,683,308)</b>	<b>(1,947,778)</b>
Interest income	<b>744</b>		<b>1,354</b>	
Debt conversion costs	<b>(6,849,830)</b>		<b>(6,849,830)</b>	
Change in fair value of warrant liability	<b>(170,000)</b>	<b>1,456,000</b>	<b>5,129,000</b>	<b>3,036,000</b>
<b>Total other (expense) income</b>	<b>(7,408,405)</b>	<b>373,203</b>	<b>(3,402,784)</b>	<b>1,088,222</b>
<b>Loss before income taxes</b>	<b>(9,142,191)</b>	<b>(1,860,461)</b>	<b>(7,445,688)</b>	<b>(2,932,978)</b>
Income tax provision (benefit)			<b>(663,900)</b>	
<b>Net loss</b>	<b>\$ (9,142,191)</b>	<b>\$ (1,860,461)</b>	<b>\$ (6,781,788)</b>	<b>\$ (2,932,978)</b>
Basic net loss per share	<b>\$ (2.29)</b>	<b>\$ (1.38)</b>	<b>\$ (2.54)</b>	<b>\$ (2.19)</b>
Diluted net loss per share	<b>\$ (2.29)</b>	<b>\$ (2.32)</b>	<b>\$ (4.46)</b>	<b>\$ (4.20)</b>
Basic Weighted Average Shares Outstanding	<b>3,985,663</b>	<b>1,346,124</b>	<b>2,667,799</b>	<b>1,337,702</b>
Diluted Weighted Average Shares Outstanding	<b>3,985,663</b>	<b>1,429,735</b>	<b>2,667,799</b>	<b>1,421,313</b>

See Notes to Unaudited Consolidated Financial Statements.

**Table of Contents****Consolidated Statements of Changes in Stockholders' Equity (Deficit)**

For the year six-months ended June 30, 2013 (Unaudited)

	Preferred Stock Series A		Preferred Stock Series B		Common Stock		Additional	Treasury	Accumulated	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Paid-in Capital	Stock	Deficit	
<b>Balance, December 31, 2012</b>	587,691	\$ 59	1,821,600	\$ 182	1,349,936	\$ 135	\$ 24,970,255	\$ (17,442)	\$ (48,934,585)	\$ (23,981,396)
Stock based compensation employees							215,219			215,219
Stock based compensation non-employees							54,650			54,650
Conversion of preferred stock into common stock	(587,691)	(59)	(1,821,600)	(182)	1,287,325	129	112			
Conversion of debt into common stock					963,430	96	12,595,970			12,596,066
Issuance of common stock in IPO, net of offering costs					690,000	69	3,742,574			3,742,643
Issuance of common stock pursuant to license agreement					2,000		20,000			20,000
Reclassification of derivative warrants							7,170,000			7,170,000
Exercise of warrants					24,000	3	95,997			96,000
Retirement of treasury stock								17,442	(17,442)	
Net loss									(6,781,788)	(6,781,788)
<b>Balance, June 30, 2013</b>		\$		\$	<b>4,316,691</b>	<b>\$ 432</b>	<b>\$ 48,864,777</b>	\$	<b>\$ (55,733,815)</b>	<b>\$ (6,868,606)</b>

See Notes to Unaudited Consolidated Financial Statements.

**Table of Contents****Cancer Genetics, Inc. and Subsidiary****Consolidated Statements of Cash Flows****(Unaudited)**

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net (loss)	<b>\$ (6,781,788)</b>	\$ (2,932,978)
Adjustments to reconcile net (loss) to net cash used in operating activities:		
Depreciation	<b>151,066</b>	173,496
Amortization	<b>7,615</b>	7,614
Provision for bad debts		(4,543)
Equity-based consulting and compensation expenses	<b>215,219</b>	564,684
Equity-based research and development expenses	<b>74,650</b>	
Change in fair value of warrant liability	<b>(5,129,000)</b>	(3,036,000)
Amortization of loan guarantee and financing fees	<b>612,605</b>	547,381
Accretion of discount on debt	<b>581,193</b>	928,463
Deferred rent	<b>3,245</b>	4,741
Deferred initial public offering costs expensed	<b>617,706</b>	
Write-off of debt conversion costs	<b>6,849,830</b>	
Change in working capital components:		
Accounts receivable	<b>(412,696)</b>	(43,211)
Other current assets	<b>(219,636)</b>	(205,525)
Accounts payable, accrued expenses and deferred revenue	<b>(335,837)</b>	(105,807)
<b>Net cash (used in) operating activities</b>	<b>(3,765,828)</b>	(4,101,685)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of fixed assets	<b>(42,576)</b>	(27,333)
Patent costs	<b>(31,679)</b>	(149,000)
Increase in restricted cash	<b>(50,000)</b>	(50,000)
<b>Net cash (used in) investing activities</b>	<b>(124,255)</b>	(226,333)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Principal payments on capital lease obligations	<b>(8,437)</b>	(21,474)
Proceeds from initial public offering of common stock, net of offering costs	<b>5,054,514</b>	
Payment of equity issuance costs for secondary public offering	<b>(92,941)</b>	(1,286,199)
Proceeds from warrant exercises	<b>96,000</b>	619,980
Proceeds from borrowings on notes payable		3,000,000
Principal payments on notes payable	<b>(38,151)</b>	
<b>Net cash provided by financing activities</b>	<b>5,010,985</b>	2,312,307
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>1,120,902</b>	(2,015,711)
<b>CASH AND CASH EQUIVALENTS</b>		
Beginning	<b>819,906</b>	2,417,256
Ending	<b>\$ 1,940,808</b>	\$ 401,545
<b>SUPPLEMENTAL CASH FLOW DISCLOSURE</b>		
Cash paid for interest	<b>\$ 489,509</b>	\$ 484,936

Edgar Filing: CANCER GENETICS, INC - Form 10-Q

**SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES**

Warrants issued for financing fees	<b>\$ 47,000</b>	\$ 601,000
Warrants issued with debt		940,000
Warrants issued for debt guarantee fee		755,000
Accrued offering costs	<b>50,000</b>	1,140,626
Offering costs discounted	<b>733,250</b>	
Accrued expenses reclassified as derivative warrant liability	<b>221,000</b>	148,000
Accrued expenses recorded as financing fees		274,000
Retirement of treasury stock	<b>17,442</b>	
Conversion of notes payable, lines of credit and accrued interest to common stock	<b>9,364,300</b>	
Conversion of preferred stock to common stock	<b>241</b>	
Reclassification of derivative warrants	<b>7,170,000</b>	
Reclassification of deferred offering costs to additional paid-in capital	<b>1,992,333</b>	

See Notes to Unaudited Consolidated Financial Statements.

---

## **Table of Contents**

### **Notes to Unaudited Consolidated Financial Statements**

#### ***Note 1. Organization, Description of Business, Reverse Stock Splits and Initial Public Offering***

We were incorporated in the State of Delaware on April 8, 1999 and have offices and a laboratory located in Rutherford, New Jersey. Our wholly owned subsidiary, Cancer Genetics Italia SRL ( CGI Italia ), manages the manufacturing and manufactures DNA probes. CGI Italia had approximately \$311,000 and \$329,000 in total assets at June 30, 2013 and December 31, 2012, respectively, and approximately \$48,000 and \$21,000 in total revenue for the three months ended June 30, 2013 and 2012, and approximately \$92,000 and \$36,000 in total revenue for the six months ended June 30, 2013 and 2012 respectively.

We are a diagnostics company focused on developing and commercializing proprietary genomic tests and services to improve the diagnosis, prognosis and response to treatment of cancer (theranosis). Our proprietary tests target cancers where prognosis information is critical and where predicting treatment outcomes using currently available techniques is limited. These cancers include hematological, urogenital and HPV-associated cancers. We have commercially launched MatBA<sup>®</sup> -CLL, -SLL, DLBCL and UroGenRA kidney as lab developed tests in the United States, and seek to provide our tests and services to oncologists and pathologists at hospitals, cancer centers and physician offices, as well as to biopharmaceutical companies and clinical research organizations for their clinical trials.

#### ***Reverse Stock Splits***

On February 8, 2013, we filed a charter amendment with the Secretary of State for the State of Delaware and effected a 1-for-2 reverse stock split of our common stock. On March 1, 2013, we filed another charter amendment with the Secretary of State for the State of Delaware and effected a 1-for-2.5 reverse stock split of our common stock. All shares and per share information referenced throughout the consolidated financial statements have been retroactively adjusted to reflect both reverse stock splits.

#### ***Initial Public Offering***

On April 10, 2013, we sold 690,000 shares of common stock at a public offering price of \$10.00 per share and completed our initial public offering ( IPO ) with gross proceeds of \$6.9 million (net proceeds of \$5 million). Upon the closing of the IPO, all shares of our then-outstanding Series A and Series B convertible preferred stock automatically converted into an aggregate of 1,287,325 shares of common stock. Concurrent with the IPO, certain derivative warrants with a fair value of \$7.2 million were reclassified into equity due to the lapsing of anti-dilution provisions in the warrants. Also concurrent with the IPO, \$9.6 million of debt converted into 963,430 shares of common stock. All references to our Series A convertible preferred stock in this quarterly report on Form 10-Q refer collectively to the Series A and Series A-1 convertible preferred shares.

#### ***Note 2. Significant Accounting Policies***

***Basis of presentation:*** The accompanying unaudited financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions for interim reporting as they are prescribed by the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary to make the financial statements not misleading have been included. As such, the information included in this quarterly report on Form 10-Q should be read in conjunction with the audited consolidated financial statements as of and for the year ended December 31, 2012 that are included in our prospectus filed with the SEC pursuant to Rule 424(b) under the Securities Act of 1933, as amended, on April 5, 2013 (Prospectus). The consolidated balance sheet as of December 31, 2012, included herein was derived from the audited financial statements as of that date, but does not include all disclosures including notes required by GAAP. Interim financial results are not necessarily indicative of the results that may be expected for future interim periods or for the year ending December 31, 2013.

***Liquidity/Going Concern:*** Our primary sources of liquidity have been funds generated from debt financing, the sale of shares of common and preferred stock, grants in lieu of federal income tax credits, National Institute of Health grants and sales of state NOL carryforwards. We intend to attempt to raise additional financing in the third quarter of 2013, which might not be available on favorable terms, if at all. On June 5, 2013, we filed a registration statement on Form S-1 for a proposed public offering of \$15.0 million of our common stock. We can provide no assurances that we will be able sell shares of our common stock in the proposed offering on favorable terms or at all. We can provide no assurances that any additional sources of financing will be available to us on favorable terms, if at all. If we are unable to secure additional financings we would scale back our general and administrative activities and certain of our research and development activities.

## Edgar Filing: CANCER GENETICS, INC - Form 10-Q

We believe our current cash resources will be sufficient to satisfy our liquidity requirements at our current level of operations only through August 31, 2013 and then only if we are able to extend the payment of \$3.5 million in outstanding indebtedness that matures on August 15, 2013. We need to raise additional financing in the near term, through the proposed offering or otherwise, to repay certain indebtedness and fund our current level of operations. Even if further extensions are obtained, we anticipate that we will need to secure additional financing to provide sufficient cash for normal operations.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company has suffered recurring losses from operations, has negative working capital and a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. The consolidated financial statements do not include any

---

**Table of Contents**

adjustments that might result from the outcome of this uncertainty. Refer to the section entitled "Capital Resources and Expenditure Requirements" in Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Form 10-Q of which these financial statements are a part.

*Principles of consolidation:* The accompanying consolidated financial statements include the accounts of Cancer Genetics, Inc. and our wholly owned subsidiary, Cancer Genetics Italia SRL. All significant intercompany account balances and transactions have been eliminated in consolidation.

*Use of estimates and assumptions:* The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include, among others, realization of amounts billed, realization of long-lived assets, realization of intangible assets, accruals for registration payments and assumptions used to value stock options and warrants. Actual results could differ from those estimates.

*Risks and uncertainties:* We operate in an industry that is subject to intense competition, government regulation and rapid technological change. Our operations are subject to significant risk and uncertainties including financial, operational, technological, regulatory and other risks, including the potential risk of business failure.

*Cash and cash equivalents:* Highly liquid investments with original maturities of three months or less when purchased are considered to be cash equivalents. Financial instruments which potentially subject us to concentrations of credit risk consist primarily of cash and cash equivalents. We maintain cash and cash equivalents with high-credit quality financial institutions. At times, such amounts may exceed insured limits. We have not experienced any losses in such accounts and believe we are not exposed to any significant credit risk on our cash and cash equivalents.

*Revenue recognition:* Revenue is recognized in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 605, *Revenue Recognition*, and ASC 954-605 Health Care Entities, *Revenue Recognition* which requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence that an arrangement exists; (2) delivery has occurred and title and the risks and rewards of ownership have been transferred to the customer or services have been rendered; (3) the price is fixed or determinable; and (4) collectability is reasonably assured. In determining whether the price is fixed or determinable, we consider payment limits imposed by insurance carriers and Medicare and the amount of revenue recorded takes into account the historical percentage of revenue we have collected for each type of test for each payor category. Periodically, an adjustment is made to revenue to record differences between our anticipated cash receipts from insurance carriers and Medicare and actual receipts from such payors. For the periods presented, such adjustments were not significant. For direct bill customers (including clinical trials customers), revenue is recorded based upon the contractually agreed upon fee schedule. When assessing collectability, we consider whether we have sufficient payment history to reliably estimate a payor's individual payment patterns. For new tests where there is no evidence of payment history at the time the tests are completed, we only recognize revenues once reimbursement experience can be established. We then recognize revenue equal to the amount of cash received. Sales of probes are recorded on the shipping date. We do not bill customers for shipping and handling fees and do not collect any sales or other taxes.

Revenues from grants to support product development are recognized when costs and expenses under the terms of the grant have been incurred and payments under the grants become contractually due.

*Accounts receivable:* Accounts receivable are carried at original invoice amount less an estimate for contractual adjustments and doubtful receivables, the amounts of which are determined by an analysis of individual accounts. Our policy for assessing the collectability of receivables is dependent upon the major payor source of the underlying revenue. For direct bill clients, an assessment of credit worthiness is performed prior to initial engagement and is reassessed periodically. If deemed necessary, an allowance is established on receivables from direct bill clients. For insurance carriers where there is not an established pattern of collection, revenue is not recorded until cash is received. For receivables where insurance carriers have made payments to patients instead of directing payments to the Company, an allowance is established for a portion of such receivables. After reasonable collection efforts are exhausted, amounts deemed to be uncollectible are written off against the allowance for doubtful accounts. Since the Company only recognizes revenue to the extent it expects to collect such amounts, bad debt expense related to receivables from patient service revenue is recorded in general and administrative expense in the consolidated statement of operations. Recoveries of accounts receivable previously written off are recorded when received.

*Deferred Offering costs:* Deferred offering costs represent legal, accounting and other direct costs related to our effort to raise capital through a stock offering. Future costs related to our offering activities will be deferred until the completion of the offering, at which time they will be reclassified to additional paid-in capital as a reduction of the offering proceeds. During the six months ended June 30, 2013, \$617,706 in deferred offering costs were expensed in connection with our IPO and approximately \$2.5 million in deferred offering costs were reclassified to additional paid-in capital. Additionally, \$733,250 in deferred offering costs were reduced due to discounts given by vendors associated with that

Edgar Filing: CANCER GENETICS, INC - Form 10-Q

offering and \$120,000 was refunded. At June 30, 2013 we had \$143,000 in deferred offering costs in connection with the anticipated additional financing referred to above.

---

**Table of Contents**

*Warrant liability:* We have issued certain warrants which contain an exercise price adjustment feature in the event we issue additional equity instruments at a price lower than the exercise price of the warrant. The warrants are described herein as derivative warrants. We account for these derivative warrants as liabilities. These common stock purchase warrants do not trade in an active securities market, and as such, we estimate the fair value of these warrants using the binomial lattice valuation pricing model with the assumptions as follows: The risk-free interest rate for periods within the contractual life of the warrant is based on the U.S. Treasury yield curve. The expected life of the warrants is based upon the contractual life of the warrants. Volatility is estimated based on an average of the historical volatilities of the common stock of four entities with characteristics similar to those of the Company. Prior to our IPO, the measurement date fair value of the underlying common shares was based upon an external valuation of our shares. (See Notes 8 and 9). Subsequent to the IPO, we use the closing price of our shares on the OTC Bulletin Board.

We compute the fair value of the warrant liability at each reporting period and the change in the fair value is recorded as non-cash expense or non-cash income. The key component in the value of the warrant liability is our stock price, which is subject to significant fluctuation and is not under our control. The resulting effect on our net income (loss) is therefore subject to significant fluctuation and will continue to be so until the warrants are exercised, amended or expire. Assuming all other fair value inputs remain constant, we will record non-cash expense when the stock price increases and non-cash income when the stock price decreases.

*Income taxes:* Income taxes are provided for the tax effects of transactions reported in the consolidated financial statements and consist of taxes currently due plus deferred income taxes. Deferred income taxes are recognized for temporary differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future. Deferred income taxes are also recognized for net operating loss carryforwards that are available to offset future taxable income and research and development credits. On January 22, 2013, we sold certain state net operating loss carryforwards. The proceeds of \$663,900 are included in our income tax benefit for the six months ended June 30, 2013.

*Registration payment arrangements:* We account for our obligations under registration payment arrangements in accordance with ASC 825-20, *Registration Payment Arrangements*. ASC 825-20 requires us to record a liability if we determine a registration payment is probable and if it can reasonably be estimated. As of June 30, 2013 and December 31, 2012, we have an accrued liability of \$300,000 and \$541,000, respectively, related to registration rights obligations associated with the issuance of Series B preferred stock and certain notes payable.

*Stock-based compensation:* Stock-based compensation is accounted for in accordance with the provisions of ASC 718, *Compensation-Stock Compensation*, which requires the measurement and recognition of compensation expense for all stock-based awards made to employees and directors based on estimated fair values on the grant date. We estimate the fair value of stock-based awards on the date of grant using the Black-Scholes option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods using the straight-line method. See additional information in Note 7.

All issuances of stock options or other issuances of equity instruments to employees as the consideration for services received by us are accounted for based on the fair value of the equity instrument issued.

We account for stock-based compensation awards to non-employees in accordance with ASC 505-50, *Equity Based Payments to Non-Employees*. Under ASC 505-50, we determine the fair value of the warrants or stock-based compensation awards granted as either the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. Stock-based compensation awards issued to non-employees are recorded in expense and additional paid-in capital in stockholders' deficit over the applicable service periods based on the fair value of the awards or consideration received at the vesting date.

*Subsequent events:* We have evaluated potential subsequent events through August 5, 2013, which is the date the financial statements were issued.

*Earnings (loss) per share:* Basic earnings (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares assumed to be outstanding during the period of computation. Diluted earnings per share is computed similar to basic earnings per share except that the numerator is adjusted for the change in fair value of the warrant liability (only if dilutive) and the denominator is increased to include the number of dilutive potential common shares outstanding during the period using the treasury stock method.

**Table of Contents**

Basic net income (loss) and diluted net loss per share data were computed as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Numerator:</b>				
Net income (loss) for basic earnings per share	\$ (9,142,191)	\$ (1,860,461)	\$ (6,781,788)	\$ (2,932,978)
Less gain in fair value of warrant liability		1,456,000	5,129,000	3,036,000
Net (loss) for diluted earnings per share	\$ (9,142,191)	\$ (3,316,461)	\$ (11,910,788)	\$ (5,968,978)
<b>Denominator:</b>				
Weighted-average basic common shares outstanding	3,985,663	1,346,124	2,667,799	1,337,702
Assumed conversion of dilutive securities:				
Common stock purchase warrants		83,611		83,611
Potentially dilutive common shares		83,611		83,611
Denominator for diluted earnings per share adjusted weighted-average shares	3,985,663	1,429,735	2,667,799	1,421,313
Basic net income (loss) per share	\$ (2.29)	\$ (1.38)	\$ (2.54)	\$ (2.19)
Diluted net loss per share	\$ (2.29)	\$ (2.32)	\$ (4.46)	\$ (4.20)

The following table summarizes potentially dilutive adjustments to the weighted average number of common shares which were excluded from the calculation:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Common stock purchase warrants	1,926,477	939,729	1,926,477	939,729
Stock options	507,610	584,190	507,610	584,190
Common shares issuable upon conversion of Series A Preferred Stock		352,614		352,614
Common shares issuable upon conversion of Series B Preferred Stock		364,320		364,320
	2,434,087	2,240,853	2,434,087	2,240,853

**Note 3. Revenue and Accounts Receivable**

Revenue by payor type for the three and six months ended June 30, 2013 and 2012 is comprised of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Medicare	\$ 151,052	\$ 269,838	\$ 408,115	\$ 408,605
Direct bill (including clinical trials clients)	1,226,852	344,115	1,738,199	684,247
Grants and royalty		184,500		195,000
Insurance carrier and all others	453,745	350,022	904,002	695,375
	\$ 1,831,649	\$ 1,148,475	\$ 3,050,316	\$ 1,983,227

Edgar Filing: CANCER GENETICS, INC - Form 10-Q

Accounts receivable by payor type at June 30, 2013 and December 31, 2012 consists of the following:

	<b>June 30, 2013</b>	December 31, 2012
Medicare	<b>\$ 347,677</b>	\$ 193,024
Direct bill (including clinical trials clients)	<b>388,197</b>	339,763
Insurance carrier and all others	<b>563,367</b>	353,758
Allowance for doubtful accounts	<b>(36,000)</b>	(36,000)
	<b>\$ 1,263,241</b>	\$ 850,545

**Table of Contents**

We have historically derived a significant portion of our revenue from a limited number of test ordering sites. Our test ordering sites are largely hospitals, cancer centers, reference laboratories and physician offices, as well as biopharmaceutical companies as part of a clinical trial. Oncologists and pathologists at these sites order the tests on behalf of the needs of their oncology patients or as part of a clinical trial sponsored by a biopharmaceutical company in which the patient is being enrolled. We generally do not have formal, long-term written agreements with such test ordering sites, and, as a result, we may lose these significant test ordering sites at any time.

The top five test ordering sites during the three months ended June 30, 2013 and 2012 accounted for 74% and 62% respectively, of our clinical testing volumes, with 23% and 52% respectively, of the volume coming from community hospitals. During the three months ended June 30, 2013, there was one site which accounted for more than 10% of our revenue: a clinical trials client accounted for approximately 50% of our revenue. During the three months ended June 30, 2012, there were three sites which each accounted for 10% or more of our clinical revenue: a university teaching center accounting for approximately 13%, a community hospital accounted for approximately 11%, and a community hospital network accounted for approximately 11%.

The top five test ordering sites during the six months ended June 30, 2013 and 2012 accounted for 69% and 61%, respectively, of our clinical testing volumes, with 27% and 48%, respectively, of the volume coming from community hospitals. During the six months ended June 30, 2013, there was one site which accounted for more than 10% of our revenue: a clinical trials client accounted for approximately 38% of our revenue. During the six months ended June 30, 2012, there were four sites which each accounted for approximately 10% or more of our clinical revenue: a university teaching center accounting for approximately 17%; a community hospital accounted for approximately 12%; and a clinical trials client and a community hospital network each accounted for approximately 11%.

**Note 4. Notes Payable and Lines of Credit**

Below is a summary of our short-term and long-term debt obligations as of June 30, 2013 and December 31, 2012:

	June 30, 2013	December 31, 2012
December 2011 Financing Transaction	<b>\$ 1,500,000</b>	\$ 4,000,000
Secured Note Payable, short-term	<b>64,014</b>	79,867
Unamortized debt discount		(243,300)
Notes Payable, Current Portion	<b>\$ 1,564,014</b>	\$ 3,836,567
Lines of Credit, Current Portion	<b>\$ 8,000,000</b>	\$ 3,000,000
Unamortized Debt Discount	<b>(3,500)</b>	(128,800)
Lines of Credit, Current Portion	<b>\$ 7,996,500</b>	\$ 2,871,200
December 2011 Financing Transaction	<b>\$</b>	\$ 2,000,000
2012 Convertible Debt Financing Transaction		3,000,000
December 2012 Bridge Financing Transaction		1,000,000
Other Note Payable		100,000
Secured Note Payable		22,298
Unamortized debt discount		(3,681,615)
Notes Payable, Long-Term	<b>\$</b>	\$ 2,440,683
Lines of Credit, Long-Term	<b>\$</b>	\$ 6,000,000

**Conversion of Debt concurrent with IPO**

On April 10, 2013, we completed our IPO and converted the following indebtedness into shares of common stock at the IPO price of \$10.00 per share:

Edgar Filing: CANCER GENETICS, INC - Form 10-Q

	<b>Converted Amount</b>	<b>Common Shares</b>
December 2011 Financing Transaction	\$ 4,500,000	450,000
2012 Convertible Debt Financing Transaction	3,000,000	300,000
December 2012 Bridge Financing Transaction	1,000,000	100,000
Business Lines of Credit (DAM)	1,000,000	100,000
Other Note Payable and accrued interest	134,300	13,430
	\$ 9,634,300	963,430

**Table of Contents**

In connection with the conversion of debt into common stock, we expensed the applicable remaining debt discounts of \$3.5 million, financing fees of \$419,000 and a contingently recognizable beneficial conversion feature in the converted debt of \$3 million. After conversion of the above debt, we have indebtedness of \$6,000,000 outstanding under a line of credit with Wells Fargo, \$2,000,000 outstanding under a line of credit with DAM, \$1,000,000 outstanding under a note agreement with NNJCA, \$500,000 outstanding under a note agreement with Dr. Pecora, and \$64,014 outstanding under the secured note payable.

*December 2011 Financing Transaction*

As of June 30, 2013 we had \$1.5 million outstanding under a Credit Agreement dated as of December 21, 2011, as amended and restated as of February 13, 2012.

The Credit Agreement is with John Pappajohn and Andrew Pecora (indirectly through an investment company), both members of our board of directors, and NNJCA Capital, LLC ( NNJCA ), a limited liability company of which Dr. Pecora is a member. Mr. Pappajohn originally provided \$4.0 million of financing, NNJCA originally provided \$1.5 million of financing and Dr. Pecora provided \$500,000 of financing under the Credit Agreement. On April 10, 2013, Mr. Pappajohn converted \$4.0 million and NNJCA converted \$500,000 into 450,000 shares of our common stock at the IPO price of \$10.00 per share concurrent with our IPO.

The loan bears an annual interest rate equal to the prime rate plus 6.25% (9.50% at June 30, 2013) with \$1.5 million maturing August 15, 2013. We accrued a fee due to Pecora and NNJCA of \$130,000 of which \$50,527 was paid upon conversion of the notes. The loan is secured by all of our assets, including our intellectual property, subject to prior first and second liens in favor of Wells Fargo Bank and DAM Holdings, LLC ( DAM ). Pursuant to an intercreditor agreement, the lenders have agreed that all amounts due to DAM are to be paid prior to payment to the lenders under this Credit Agreement, but that as between such lenders, following an event of default, all of the security granted by us is to be applied first to repay obligations due to Dr. Pecora and NNJCA, and then to Mr. Pappajohn after they have been paid in full. As Mr. Pappajohn has guaranteed the Wells Fargo debt, in essence under the intercreditor agreement, NNJCA and Dr. Pecora will be junior only to DAM.

*2012 Convertible Debt Financing Transaction*

On April 10, 2013, the entire \$3 million outstanding under a Restated Credit Agreement dated as of August 27, 2012, as amended and restated as of October 17, 2012, (\$1,750,000 provided by Mr. Pappajohn and \$1,250,000 provided by Mr. Oman) was converted into 300,000 shares of common stock at the IPO price of \$10 per share.

Through April 10, 2013, the loan bore interest at the prime rate plus 6.25% (9.50% at April 10, 2013). In February 2013, because we did not consummate our IPO within 181 days of funding, the lenders received ten-year warrants to purchase an aggregate of 7,059 shares of our common stock (issued in proportion to their respective funding amounts) with an exercise price equal to the lesser of (i) \$42.50 per share or (ii) the IPO price per share, which was \$10.00. The warrant exercise price is subject to standard anti-dilution protection in the event of stock splits, stock dividends, stock combinations, reclassifications and the like.

*December 2012 Bridge Financing Transaction*

On April 10, 2013, the entire \$1 million outstanding under a credit agreement dated as of December 7, 2012, (all of which was provided by Mr. Pappajohn), was converted into 100,000 shares of common stock at the IPO price of \$10 per share.

Through April 10, 2013, the loan bore interest at the prime rate plus 6.25% (9.50% at April 10, 2013). The credit agreement required Mr. Pappajohn to convert the outstanding principal balance into shares of our common stock at a conversion price equal to the lesser of \$42.50 or our IPO price and as a result all debt was converted on April 10, 2013 at the IPO price of \$10 per share. In March 2013, Mr. Pappajohn received ten-year warrants to purchase an aggregate of 2,353 shares of our common stock with an exercise price equal to the lesser of (i) \$42.50 per share or (ii) the IPO or merger price per share, which was \$10, because we did not consummate our IPO by March 7, 2013. The warrant exercise price is subject to standard anti-dilution protection in the event of stock splits, stock dividends, stock combinations, reclassifications and the like.

*Business Line of Credit Wells Fargo*

At June 30, 2013 and December 31, 2012, we have fully utilized a line of credit with Wells Fargo Bank which provides for maximum borrowings of \$6 million. Interest on the line of credit is due monthly equal to 1.75% above the Daily One Month LIBOR rate (1.95% at June 30, 2013). The line of credit requires the repayment of principal, and any unpaid interest, in a single payment due upon maturity. The line of credit matures April 1, 2014, is guaranteed by Mr. Pappajohn, and is collateralized by a first lien on all of our assets including the assignment

of our approved and pending patent applications.

---

## **Table of Contents**

### *Business Line of Credit DAM*

At June 30, 2013 and December 31, 2012, \$2 million and \$3 million, respectively, was outstanding under a line of credit agreement with DAM. On April 10, 2013, \$1 million of indebtedness under this line was converted into 100,000 shares of common stock at the IPO price of \$10 per share.

Pursuant to an intercreditor agreement between Mr. Pappajohn and DAM (the *Intercreditor Agreement*), we were required to use the proceeds from our IPO to repay the full amount outstanding under the DAM Loan Agreement before any proceeds can be used to repay any debt outstanding under the Wells Fargo Line of Credit. On February 13, 2013, DAM agreed to convert \$1.0 million which had been due April 1, 2013 of outstanding indebtedness into shares of common stock at the IPO price per share. We had accrued a fee due to DAM of \$52,500 of which \$35,422 was paid upon conversion of the line of credit. On March 19, 2013, the maturity date for \$2 million of the DAM debt was extended to mature on August 15, 2013. The DAM debt bears an annual interest rate of 10% payable in equal monthly installments. After a maturity event occurs, interest begins to compound at a rate of 18% per annum until the balance is paid in full.

### *Secured Note Payable*

On September 25, 2012, we entered into a note payable secured by lab equipment due March 25, 2014. The note requires monthly payments of principal and interest at 18% per annum. At June 30, 2013, \$64,014 was outstanding under the note. At December 31, 2012, \$102,165 was outstanding under the note.

### *Other Note Payable*

At December 31, 2012, notes payable included a \$100,000 note payable to Dr. Chaganti, our Chairman of the Board. Accrued interest at December 31, 2012 was approximately \$34,300. The note bore interest at 8.5% per annum. On April 10, 2013, the note and accrued interest converted into 13,430 shares of common stock at the IPO price of \$10.00 per share.

## **Note 5. Letter of Credit**

Pursuant to the terms of our lease for our Rutherford facility, during the second fiscal quarter of 2013 we restricted an additional \$50,000 in cash in addition to the \$250,000 that was previously restricted in order to secure a \$300,000 letter of credit in favor of our landlord.

## **Note 6. Capital Stock**

On April 10, 2013, we completed our IPO in which we issued and sold 690,000 shares of common stock (including the underwriter's over-allotment of 90,000 shares) at a public offering price of \$10.00 per share. In connection with the offering, all outstanding shares of Series A preferred stock were converted into 376,525 shares of common stock, and all outstanding shares of Series B preferred stock were converted into 910,800 shares of common stock. Concurrent with the IPO, we issued 2,000 shares of common stock to Cleveland Clinic pursuant to our license agreement with Cleveland Clinic.

We are currently authorized to issue up to 9,764,000 shares of preferred stock.

## **Note 7. Stock Option Plans**

We have two equity incentive plans: the 2008 Stock Option Plan (the *2008 Plan*) and the 2011 Equity Incentive Plan (the *2011 Plan*), and together with the 2008 Plan, the *Stock Option Plans*). The 2011 Plan was approved by the Board of Directors on June 30, 2011 and was subsequently ratified by stockholders. The 2011 Plan authorizes the issuance of up to 350,000 shares of common stock under several types of equity awards including stock options, stock appreciation rights, restricted stock awards and other awards defined in the 2011 Plan. There have been no awards under the 2011 Plan.

The Board of Directors adopted the 2008 Plan on April 29, 2008 and reserved 251,475 shares of common stock for issuance under the plan. On April 1, 2010, the stockholders voted to increase the number of shares reserved by the plan to 550,000. The 2008 Plan is meant to provide additional incentive to officers, employees and consultants to remain in our employment. We are authorized to issue incentive stock options or non-statutory stock options to eligible participants. Options granted are generally exercisable for up to 10 years.



**Table of Contents**

At June 30, 2013, 122,390 shares remain available for future awards under the 2008 Plan and 350,000 shares remain available for future awards under the 2011 Plan.

As of June 30, 2013, no stock appreciation rights, restricted stock, or awards other than stock options had been awarded under the Stock Option Plans.

We have also issued 80,000 options outside of the Stock Option Plans.

The Board of Directors authorized an offer to certain employee options holders on the following terms: those employees holding stock options with a strike price of \$25.00 or more had the opportunity to exchange their options for 60% of the number of options currently held with an exercise price equal to the IPO price, which was \$10.00 per share, and those employees holding stock options with a strike price of \$12.50 had the opportunity to exchange their options for 80% of the number of options currently held with an exercise price equal to the IPO price which was \$10.00 per share. On April 5, 2013, our initial public offering became effective and 336,300 options with exercise prices ranging from \$12.50 to \$33.80 were exchanged for 242,070 options with an exercise price of \$10.00. In addition, 53,500 options which were approved to be issued and priced at the IPO price were issued to employees with an exercise price of \$10.00 per share.

On April 17, 2013, we issued 5,850 options to employees with an exercise price of \$11.75 per share as approved by the Board of Directors.

A summary of employee and nonemployee stock option activity for year ended December 31, 2012 and the six months ended June 30, 2013 is as follows:

	Options Outstanding Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding January 1, 2012	559,990	\$ 12.85	8.10	\$ 11,737,710
Granted	2,400	33.80		
Cancelled or expired	(9,050)	23.43		
Outstanding December 31, 2012	553,340	\$ 12.76	7.13	\$ 1,142,432
Granted	59,350	10.17		
Cancelled or expired	(105,080)	20.61		
Outstanding June 30, 2013	507,610	\$ 7.61	6.78	\$ 1,217,614
Exercisable, June 30, 2013	375,358	\$ 6.87	6.44	\$ 1,168,635

Aggregate intrinsic value represents the difference between the estimated fair value of our common stock and the exercise price of outstanding, in-the-money options. The estimated fair value of our common stock was \$9.96 and \$9.60 as of June 30, 2013 and December 31, 2012, respectively. No options were exercised during the six months ended June 30, 2013 and 2012.

As of June 30, 2013 and December 31, 2012, total unrecognized compensation cost related to nonvested stock options granted to employees was \$879,831 and \$846,810, respectively, which we expect to recognize over the next 2.80 and 2.61 years, respectively.

As of June 30, 2013 and December 31, 2012, total unrecognized compensation cost related to nonvested stock options granted to non-employees was \$27,300 and \$190,500, respectively, which we expect to recognize over the next quarter and six months, respectively. The estimate of unrecognized nonemployee compensation is based on the fair value of the nonvested options as of June 30, 2013 and December 31, 2012.

The following table summarizes information about outstanding and vested stock options granted to employees and non-employees as of June 30, 2013 as follows:

Edgar Filing: CANCER GENETICS, INC - Form 10-Q

Exercise Price	Options Outstanding			Options Vested and Exercisable	
	Number of Shares Outstanding	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
4.00	175,000	5.84	\$ 4.00	175,000	\$ 4.00
4.80	33,840	6.55	4.80	24,348	4.80
10.00	292,970	7.32	10.00	175,910	10.00
11.75	5,600	9.79	11.75		
12.50	200	7.44	12.50	100	12.50
Total	507,610	6.78	\$ 7.61	375,358	\$ 6.87

**Table of Contents**

The fair value of options granted to employees is estimated on the grant date using the Black-Scholes option valuation model. This valuation model for stock-based compensation expense requires us to make assumptions and judgments about the variables used in the calculation, including the fair value of our common stock (see Note 9), the expected term (the period of time that the options granted are expected to be outstanding), the volatility of our common stock, a risk-free interest rate, and expected dividends. We also estimate forfeitures of unvested stock options. To the extent actual forfeitures differ from the estimates, the difference will be recorded as a cumulative adjustment in the period estimates are revised. No compensation cost is recorded for options that do not vest. We use the simplified calculation of expected life described in the SEC's Staff Accounting Bulletin No. 107, *Share-Based Payment*, and volatility is based on an average of the historical volatilities of the common stock of four entities with characteristics similar to those of the Company. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option. We use an expected dividend yield of zero, as we do not anticipate paying any dividends in the foreseeable future. Expected forfeitures are assumed to be zero due to the small number of plan participants and the plan design which has monthly vesting after an initial cliff vesting period.

The following table presents the weighted-average assumptions used to estimate the fair value of options granted to employees during the periods presented:

	Three Months Ended	Six Months Ended June 30,	
	June 30, 2013 <sup>A</sup>	2013	2012
Volatility	77.11%	77.11%	74.39%
Risk free interest rate	0.76%	0.76%	1.43%
Dividend yield	0.00%	0.00%	0.00%
Term (years)	5.95	5.95	6.50
Weighted-average fair value of options granted during the period	\$ 6.72	\$ 6.72	\$ 9.34

<sup>A</sup> There were no options granted during the three months ended June 30, 2012.

In 2010, we issued an aggregate of 80,000 options to non-employees with an exercise price of \$25.00. The following table presents the weighted-average assumptions used to estimate the fair value of options reaching their measurement date for non-employees during the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Volatility	76.21%	74.93%	76.04%	74.90%
Risk free interest rate	1.23%	1.44%	1.24%	1.45%
Dividend yield	0.00%	0.00%	0.00%	0.00%
Term (years)	7.46	8.35	7.58	8.52

The following table presents the effects of stock-based compensation related to stock option awards to employees and nonemployees on our Statement of Operations during the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Cost of revenues	\$ 11,967	\$ 5,191	\$ 14,179	\$ 8,431
Research and development	35,962	129,537	90,798	269,112
General and administrative	94,112	86,314	152,267	160,724
Sales and marketing	30,693	66,775	32,625	126,417
Total stock-based compensation	\$ 172,734	\$ 287,817	\$ 289,869	\$ 564,684



**Table of Contents**

**Note 8. Warrants**

We have issued certain warrants which contain an exercise price adjustment feature in the event we issue additional equity instruments at a price lower than the exercise price of the warrant. The warrants are described herein as derivative warrants. For all derivative warrants, in the event equity instruments are issued at a price lower than the exercise price of the warrant, the exercise price is adjusted to the price of the new equity instruments issued (price adjustment feature). For certain of these warrants, the number of shares underlying the warrant is also adjusted to an amount computed by dividing the proceeds of the warrant under its original terms by the revised exercise price (share adjustment feature). These warrants are initially recorded as a warrant liability at fair value with a corresponding entry to the loan guarantee fee asset, debt discount, additional paid-in capital or expense dependent upon the service provided in exchange for the warrant grant. Subsequently, any change in fair value is recognized in earnings until such time as the warrants are exercised, amended or expire.

In connection with the 2012 Convertible Debt Financing Transaction, we granted 4,118 warrants to Mr. Pappajohn and 2,941 warrants to Mr. Oman on February 22, 2013. The warrants have a ten-year term and an exercise price equal to the IPO price of \$10.00 per share. These warrants were initially recorded at fair value as a financing fee asset and were amortized over the period of the note to interest expense. The issue date fair value of these warrants was \$221,000.

In connection with the December 2012 Bridge Financing Transaction, we granted 2,353 ten-year warrants with an exercise price equal to the IPO price of \$10.00 per share to Mr. Pappajohn on March 7, 2013. These warrants were initially recorded at fair value as a financing fee asset and were amortized over the period of the note to interest expense. The issue date fair value of these warrants was \$47,000.

On February 11, 2013, John Pappajohn agreed to limit certain anti-dilution rights in his warrants to purchase shares of the Company's common stock. Subject to the consummation of an IPO prior to April 13, 2013, Mr. Pappajohn agreed that if the final IPO price was below \$15.00, the exercise price of the warrants held by him would adjust to \$15.00 and the number of shares underlying the warrants would be adjusted as if the IPO price were \$15.00 and then there would be no further adjustment to the price or number of shares covered by warrants held by him. In February 2013, certain warrant holders agreed to waive the price and share adjustment provisions of their warrants, except for the anti-dilution provisions related to stock splits, subdivisions and combinations, with respect to an aggregate of 114,030 shares of common stock underlying such warrants, effective immediately following the consummation of our IPO on April 10, 2013 at \$10.00 per share.

On April 10, 2013, the Company completed the IPO at \$10.00 per share. The shares of common stock issuable upon the exercise of warrants increased by 838,889 shares and the exercise prices of 1,656,860 warrants were adjusted as a result of share and exercise price adjustment features in certain warrants.

On April 29, 2013, the Company received \$96,000 from shareholders who exercised warrants to purchase 24,000 shares of common stock at \$4.00 per share.

**Table of Contents**

The following table summarizes the warrant activity for the six months ended June 30, 2013:

Issued With / For	Exercise Price	Warrants Outstanding January 1, 2013	2013 Warrants Issued	2013 Warrants Exercised	IPO Adjustments(E)	Warrants Outstanding June 30, 2013
<b>Non-Derivative Warrants:</b>						
Financing	\$ 10.00				243,334	243,334
Financing	15.00				436,079	436,079
Debt Guarantee	4.00	228,288		(24,000)		204,288
Debt Guarantee	10.00				237,500	237,500
Debt Guarantee	15.00				585,645	585,645
Series A Pref. Stock	14.10	65,329				65,329
Consulting	10.00				29,138	29,138
	12.30 <sup>F</sup>	293,617		(24,000)	1,531,696	1,801,313
<b>Derivative Warrants:</b>						
Financing	10.00 <sup>B</sup>				60,000	60,000
Financing	25.00 <sup>B</sup>	60,000			(60,000)	
Financing	42.50 <sup>BCD</sup>	75,294			(75,294)	
Financing	42.50 <sup>AD</sup>	54,314	2,941		(57,255)	
Financing	42.50 <sup>ACD</sup>	120,865	6,471		(127,336)	
Debt Guarantee	10.00 <sup>A</sup>				12,500	12,500
Debt Guarantee	25.00 <sup>ACD</sup>	212,000			(212,000)	
Debt Guarantee	25.00 <sup>AD</sup>	95,000			(95,000)	
Debt Guarantee	25.00 <sup>A</sup>	5,000			(5,000)	
Debt Guarantee	32.45 <sup>ACD</sup>	40,000			(40,000)	
Debt Guarantee	42.50 <sup>ACD</sup>	38,392			(38,392)	
Debt Guarantee	42.50 <sup>BCD</sup>	37,000			(37,000)	
Series B Pref. Stock	10.00 <sup>B</sup>				52,464	52,464
Series B Pref. Stock	25.00 <sup>B</sup>	52,464			(52,464)	
Consulting	10.00 <sup>B</sup>				200	200
Consulting	12.50 <sup>AD</sup>	4,030			(4,030)	
Consulting	14.10 <sup>AD</sup>	10,000			(10,000)	
Consulting	25.00 <sup>B</sup>	200			(200)	
Consulting	25.00 <sup>AD</sup>	4,000			(4,000)	
	10.00 <sup>F</sup>	808,559	9,412		(692,807)	125,164
	\$ 12.15 <sup>F</sup>	1,102,176	9,412	(24,000)	838,889	1,926,477

<sup>A</sup> These warrants are subject to fair value accounting and contain exercise price and number of share adjustment features. See Note 9.

<sup>B</sup> These warrants are subject to fair value accounting and contain an exercise price adjustment feature. See Note 9.

<sup>C</sup> On February 11, 2013, these warrants held by John Pappajohn were amended to limit the adjustment feature(s) to \$15.00 per share in an initial public offering (totaling 530,022 warrants).

<sup>D</sup> The exercise price and/or number of share adjustment features of these warrants expired and are no longer subject to fair value accounting after our initial public offering.

<sup>E</sup> On April 10, 2013 the Company completed the IPO at \$10.00 per share. The shares of common stock issuable upon the exercise of warrants outstanding as of June 30, 2013 increased to 1,926,477 shares and the exercise prices of 1,656,860 warrants were adjusted as a result of the share and exercise price adjustment features described above.

<sup>F</sup> Weighted average exercise prices are as of June 30, 2013.

**Subsequent Events**

## Edgar Filing: CANCER GENETICS, INC - Form 10-Q

On July 6, 2013, a warrant holder exercised a warrant to purchase 6,000 shares of common stock at an exercise price of \$4.00 per share using the net issuance exercise method whereby 2,072 shares were surrendered as payment in full of the exercise price resulting in a net issuance of 3,928 shares.

On July 8, 2013, the Company received \$96,000 from shareholders who exercised warrants to purchase 24,000 shares of common stock at \$4.00 per share.

**Table of Contents****Note 9. Fair Value of Warrants**

The following tables summarize the assumptions used in computing the fair value of derivative warrants subject to fair value accounting at the date of issue during the six months ended June 30, 2013 and 2012 and at June 30, 2013, April 5, 2013 (IPO valuation date) and December 31, 2012. In computing the fair value of the warrants, if the stated exercise price of the warrants exceeded the assumed value of the Company stock at the date the fair value was being computed, the exercise price and number of shares (if applicable) underlying the warrants were adjusted to reflect an assumed trigger of the price and/or share adjustment features related to the applicable warrants:

	Issued During the Six Months Ended June 30, 2012	As of June 30, 2013	As of April 5, 2013	As of December 31, 2012
<b>Debt Guarantee</b>				
Exercise Price	\$ 42.50	\$ 10.00	\$ 13.56	\$ 9.60
Expected life (years)	4.73	1.33	2.42	2.66
Expected volatility	80.47%	56.12%	66.37%	67.71%
Risk-free interest rate	0.90%	0.15%	0.32%	0.37%
Expected dividend yield	0.00%	0.00%	0.00%	0.00%

	As of June 30, 2013	As of December 31, 2012
<b>Series B</b>		
Exercise Price	\$ 10.00	\$ 9.60
Expected life (years)	2.42	2.92
Expected volatility	62.22%	61.44%
Risk-free interest rate	0.36%	0.36%
Expected dividend yield	0.00%	0.00%

	As of June 30, 2013	As of April 5, 2013	As of December 31, 2012
<b>Consulting</b>			
Exercise Price	\$ 10.00	\$ 10.00	\$ 9.60
Expected life (years)	2.65	2.33	2.48
Expected volatility	60.70%	63.20%	63.29%
Risk-free interest rate	0.66%	0.27%	0.28%
Expected dividend yield	0.00%	0.00%	0.00%

	Issued During the Six Months Ended June 30,		Issued During the Three Months Ended		As of December 31,	
	2013	2012	June 30, 2012	As of June 30, 2013	As of April 5, 2013	2012
<b>Financing</b>						
Exercise Price	\$ 13.34	\$ 42.50	\$ 42.50	\$ 10.00	\$ 13.21	\$ 9.60
Expected life (years)	9.78	4.84	4.91	2.75	8.30	6.66
Expected volatility	74.70%	79.43%	79.52%	60.95%	73.22%	73.38%
Risk-free interest rate	1.95%	0.84%	0.89%	0.66%	1.44%	1.06%
Expected dividend yield	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%

The assumed Company stock price used in computing the warrant fair value for warrants issued during the six months ended June 30, 2013 was \$9.60 \$9.96 and \$29.85 \$33.80 for the six months ended June 30, 2012. In determining the fair value of warrants issued at each reporting date, the assumed Company stock price was \$9.96 at June 30, 2013 and \$9.60 at December 31, 2012.



**Table of Contents**

The following table summarizes the derivative warrant activity subject to fair value accounting for the six months ended June 30, 2013:

Issued with/for	Fair value of warrants outstanding as of December 31, 2012	Fair value of warrants issued	Reclassification to equity in IPO	Change in fair value of warrants	Fair value of warrants outstanding as of June 30, 2013
Series B Preferred Stock	\$ 230,000	\$	\$	\$ (12,000)	\$ 218,000
Debt Guarantee	5,679,000		(2,514,000)	(3,129,000)	36,000
Consulting	147,000		(108,000)	(38,000)	1,000
Financing	6,493,000	268,000	(4,548,000)	(1,950,000)	263,000
	\$ 12,549,000	\$ 268,000	\$ (7,170,000)	\$ (5,129,000)	\$ 518,000

**Note 10. Fair Value Measurements**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The Fair Value Measurements and Disclosures Topic of the FASB Accounting Standards Codification requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect our own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the Topic establishes a fair value hierarchy for valuation inputs that give the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that we have the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect our own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The following table summarizes the financial liabilities measured at fair value on a recurring basis segregated by the level of valuation inputs within the fair value hierarchy utilized to measure fair value:

	June 30, 2013			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Warrant liability	\$ 518,000			\$ 518,000

  

	December 31, 2012			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Warrant liability	\$ 12,549,000			\$ 12,549,000

## Edgar Filing: CANCER GENETICS, INC - Form 10-Q

The warrant liability consists of stock warrants we issued that contain an exercise price adjustment feature. In accordance with derivative accounting for warrants, we calculated the fair value of warrants and the assumptions used are described in Note 9, Fair Value of Warrants . Realized and unrealized gains and losses related to the change in fair value of the warrant liability are included in Other income (expense) on the Statement of Operations.

**Table of Contents**

The following table reflects the activity for liabilities measured at fair value using Level 3 inputs for the six months ended June 30:

	2013	2012
Balance as of January 1	\$ 12,549,000	\$ 11,113,000
Issuances of derivative financial instruments	268,000	2,296,000
Derivative financial instruments reclassified to equity in IPO	(7,170,000)	
Unrealized (gain) loss related to change in fair value	(5,129,000)	(3,036,000)
<b>Balance as of June 30</b>	<b>\$ 518,000</b>	<b>\$ 10,373,000</b>

**Note 11. Joint Venture Agreement**

In November 2011, we entered into an affiliation agreement with the Mayo Foundation for Medical Education and Research ( Mayo ) pursuant to which we formed a joint venture with Mayo in May 2013. The joint venture will take the form of a limited liability company, with each party initially holding fifty percent of the issued and outstanding membership interests of the new entity (the JV ). In exchange for the membership interests in the JV, we are required to make an initial capital contribution of \$1.0 million (and potentially capital contributions up to \$6.0 million, subject to the joint venture entity's achievement of certain operational milestones) over the next three years. The initial capital contribution was due on July 31, 2013, and not made, but while no assurances can be given, we believe Mayo will not declare a default and will extend the date for this payout. In exchange for its membership interests, Mayo's capital contribution will take the form of cash, staff, services, hardware and software resources, laboratory space and instrumentation, the fair market value of which will be approximately equal to \$6 million. Mayo's continued contribution will also be conditioned upon the JV's achievement of certain milestones. We are currently negotiating an amendment to our agreement to fund the joint venture to extend the dates and our payment schedule.

**Note 12. Related Party Transactions**

John Pappajohn, a member of the Board of Directors and stockholder, personally guarantees our revolving line of credit with Wells Fargo Bank. As consideration for his guarantee, as well as each of the eight extensions of this facility through June 30, 2013, Mr. Pappajohn received warrants to purchase an aggregate of 1,051,506 shares of common stock of which Mr. Pappajohn assigned warrants to purchase 284,000 shares of common stock to certain third parties. Warrants to purchase 395,825 shares of common stock have been exercised by Mr. Pappajohn through June 30, 2013. After adjustment pursuant to the terms of the warrants in conjunction with our IPO, the number of these warrants outstanding retained by Mr. Pappajohn was 585,645 at \$15.00 per share and 44,288 at \$4.00 per share.

In addition, John Pappajohn also has loaned us an aggregate of \$6,750,000. In connection with these loans, Mr. Pappajohn received warrants to purchase an aggregate of 202,630 shares of common stock. After adjustment pursuant to the terms of the warrants in conjunction with our IPO, the number of warrants outstanding was 436,079 at \$15.00 per share at June 30, 2013.

As of June 30, 2013 we had \$1.5 million outstanding under a Credit Agreement dated as of December 21, 2011, as amended and restated as of February 13, 2012. Andrew Pecora (indirectly through an investment company), a member of our board of directors, and NNJCA, a limited liability company of which Dr. Pecora is a member originally provided \$1.5 million and \$500,000 of financing, respectively. On April 10, 2013, NNJCA converted \$500,000 of its outstanding indebtedness into 50,000 shares of our common stock at the IPO price of \$10.00 per share concurrent with our IPO.

The loan bears an annual interest rate equal to the prime rate plus 6.25% (9.50% at June 30, 2013) with the remaining \$1.5 million maturing August 15, 2013. We had accrued a fee due to Pecora and NNJCA of \$130,000 of which \$50,527 was paid upon conversion of the notes. The loan is secured by all of our assets, including our intellectual property, subject to prior first and second liens in favor of Wells Fargo Bank and DAM Holdings, LLC ( DAM ). Pursuant to an intercreditor agreement, the lenders have agreed that all amounts due to DAM are to be paid prior to payment to the lenders under this Credit Agreement, but that as between such lenders, following an event of default, all of the security granted by us is to be applied first to repay obligations due to Dr. Pecora and NNJCA, and then to Mr. Pappajohn after they have been paid in full. As Mr. Pappajohn has guaranteed the Wells Fargo debt, in essence under the intercreditor agreement, NNJCA and Dr. Pecora will be junior only to DAM.

On May 19, 2006, we issued a convertible promissory note in favor of our Chairman and founder, Dr. Chaganti, the holder, which obligates us to pay the holder the sum of \$100,000, together with interest at the rate of 8.5% per annum, due April 1, 2014. Interest expense for the six months ended June 30, 2013 and 2012 totaled \$2,357 and \$4,200, respectively. (see Note 4 for additional



**Table of Contents**

information regarding the conversion of the promissory note into common stock concurrent with our IPO on April 10, 2013.). Pursuant to a consulting and advisory agreement, Dr. Chaganti also received options to purchase a total of 36,000 shares of common stock at price of \$10.00 per share which vested over a two year period. Total non-cash stock-based compensation recognized under the consulting agreement for the six months ended June 30, 2013 and 2012 were \$54,650 and \$254,500, respectively. Additionally, we entered into a three-year consulting agreement with Dr. Chaganti expiring on September 30, 2013 pursuant to which Dr. Chaganti receives \$5,000 per month for providing consulting and technical support services. Total expenses for each of the six month periods ended June 30, 2013 and 2012 were \$30,000.

On August 15, 2010, we entered into a two-year consulting agreement with Dr. Pecora, a member of our board of directors, pursuant to which Dr. Pecora received \$5,000 per month for providing consulting and advisory services. Dr. Pecora also received stock options under the consulting and advisory agreement to purchase a total of 12,000 shares of common stock at price of \$10.00 per share which vested over a two year period. The cash component of this agreement was terminated by mutual consent in 2011. Total non-cash stock-based compensation recognized under the consulting agreement for the six months ended June 30, 2013 and 2012 were \$0 and \$112,320, respectively.

In August 2010, we entered into a consulting agreement with Equity Dynamics, Inc., an entity controlled by John Pappajohn, pursuant to which Equity Dynamics, Inc. receives a monthly fee of \$10,000 plus reimbursement of expenses. Total consulting fees for each of the six month periods ended June 30, 2013 and 2012 were \$60,000. As of June 30, 2013, we owed Equity Dynamics, Inc. \$86,917.

**Note 13. Contingencies**

In the normal course of business, the Company may become involved in various claims and legal proceedings. In the opinion of management, the ultimate liability or disposition thereof is not expected to have a material adverse effect on our financial condition, results of operations, or liquidity.

## Table of Contents

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

As used herein, the Company, we, us, our or similar terms, refer to Cancer Genetics, Inc. and its wholly owned subsidiary, Cancer Genetics Italia, S.R.L. except as expressly indicated or unless the context otherwise requires. The following Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) is intended to help facilitate an understanding of our financial condition and our historical results of operations for the periods presented. This MD&A should be read in conjunction with the accompanying unaudited consolidated financial statements and the audited consolidated financial statements and notes thereto included in our Prospectus filed with the SEC pursuant to Rule 424 (b) under the Securities Exchange Act of 1933. This MD&A may contain forward-looking statements that involve risks and uncertainties. See Forward-Looking Statements below.

#### **Overview**

We are an early-stage diagnostics company focused on developing and commercializing proprietary genomic tests and services to improve and personalize the diagnosis, prognosis and response to treatment (theranosis) of cancer. Our proprietary tests target cancers that are complicated to prognose and for which it is difficult to predict treatment outcomes using currently available mainstream techniques. These cancers include hematological, urogenital and HPV-associated cancers. We provide our proprietary tests and services along with a comprehensive range of non-proprietary oncology-focused tests and laboratory services, to oncologists and pathologists at hospitals, cancer centers, reference laboratories and physician offices, as well as to biopharmaceutical companies and clinical research organizations for their clinical trials. To date, we have engaged in only limited sales and marketing activities and have generated most of our revenue through sales of our non-proprietary testing services to a limited number of oncologists, pathologists, community hospitals and biotechnology and pharmaceutical companies located mostly in the eastern and midwestern United States. Our non-proprietary laboratory testing services include molecular testing, sequencing, mutational analysis, flow cytometry testing, histology testing and cytology testing. We are currently offering our tests and laboratory services in our 17,936 square foot state-of-the-art laboratory located in Rutherford, New Jersey, which has been accredited by the College of American Pathologists, which is one of six approved accreditation methods under the Clinical Laboratory Improvement Amendments of 1988 ( CLIA ), to perform high complexity testing.

Our proprietary tests are based principally on our expertise in specific cancer types, test development methodologies and proprietary algorithms correlating genetic events with disease specific information. We have commercially launched MatBA<sup>®</sup>-CLL, our first proprietary microarray test for chronic lymphocytic leukemia ( CLL ) for use in our CLIA-accredited clinical laboratory. In January 2012, we received CLIA approval for MatBA<sup>®</sup>-SLL, our proprietary microarray for risk stratification in small lymphocytic lymphoma ( SLL ), and we are currently offering MatBA<sup>®</sup>-SLL in our laboratory. In February 2013, we received CLIA approval for MatBA<sup>®</sup>-DLBCL, our proprietary microarray for diagnosis, prognosis and patient monitoring in diffuse large B cell lymphoma ( DLBCL ). In May 2013, we commercially launched UroGen<sup>RA</sup>, our proprietary microarray for the diagnosis and prognosis of patients with kidney cancer for use in our CLIA-accredited clinical laboratory. We have also launched FHACT for cervical cancer outside the United States. In addition, we are developing a series of other proprietary genomic tests in our core oncology markets. Revenues from our proprietary MatBA<sup>®</sup> test represented approximately 4% of our 2012 revenues. Due to the recent introduction of this test, the small numbers involved in our revenues, and the variability expected with the adoption of any new tests, no assurance or prediction can be given with respect to the level of revenues from our proprietary tests in the future.

We have established collaborative relationships with key thought leaders in oncology, which enable us to develop and validate the effectiveness and utility of our tests in a clinical setting and which provide us access to clinically-robust patient data. For example, we formed a joint venture in May 2013 with Mayo Foundation for Medical Education and Research which, once funded by us, will focus on developing oncology diagnostic services and tests utilizing next-generation sequencing. Additionally, we agreed to a research collaboration with Memorial Sloan-Kettering Cancer Center and the Cleveland Clinic to validate our renal-cancer microarray, UroGen<sup>RA</sup> -Renal.

The non-proprietary testing services we offer are entirely focused on specific oncology categories where we are developing our proprietary arrays and probe panels. We believe that there is significant synergy in developing and marketing a complete set of tests and services that are disease-focused and delivering those tests and services in a comprehensive manner to help with treatment decisions. The insight that we develop in delivering the non-proprietary services are often leveraged in the development of our proprietary programs and now increasingly in the validation of our proprietary programs (such as MatBA<sup>®</sup>) for clinical use.

We believe that we can be successful by offering cancer professionals a fully-integrated menu of oncology-focused proprietary and non-proprietary tests and customized laboratory services. Based on our discussions with leading researchers in the oncology field and interactions with our collaborators, as well as information we learn through performing the non-proprietary genetic diagnostic testing services, which are focused on the specific oncology categories where we are developing our proprietary tests, we believe our proprietary tests provide superior diagnostic and prognostic values than currently available tests. In particular, our proprietary tests deliver a level of genomic information not provided by other currently available tests. For example, the majority of current cytogenetic analysis for CLL and SLL that is available in clinical laboratories today assesses gain and loss in genomic material at four specific sites. There are two other marketed arrays for CLL (GenPath/Bioreference Laboratories and Quest) of which we are aware. Both of these



**Table of Contents**

arrays report out gains and losses at four to five genomic sites. MatBA<sup>®</sup>-CLL, on the other hand, is designed to report out gains and losses at twenty genomic sites and MatBA<sup>®</sup>-SLL can report out gains and losses at thirteen genomic sites. We believe our ability to rapidly translate research insights about the genetics and molecular mechanisms of cancer into the clinical setting will improve patient treatment and management and that this approach will become a key component in the standard of care for personalized cancer treatment.

We will offer our proprietary tests in the United States as laboratory developed tests ( LDTs ) and internationally as CE-marked in vitro diagnostic products. In addition, as part of our long-term strategy we plan to seek Food and Drug Administration ( FDA ) clearance or approval to expand the commercial use of our tests to other laboratories and testing sites. We believe it would likely take two years or more to conduct the studies and trials necessary to obtain approval from FDA to commercially launch our propriety tests outside of our clinical laboratory. Our sales strategy is focused on direct sales to oncologists and pathologists at hospitals, cancer centers, and physician offices in the United States and expanding our relationships with leading distributors and medical facilities in emerging markets. We intend to emphasize partnering with community hospitals, where nearly 85% of all cancers are initially diagnosed, through our program called Expand Dx , which was specifically designed to meet the needs of community hospitals. We believe our proprietary tests and services will enable community hospitals to optimize and expand their oncology services to better serve their cancer patients.

We expect to continue to incur significant losses for the near future. We incurred losses of \$6.7 million and \$19.9 million for fiscal years ended December 31, 2012 and 2011, respectively. As of June 30, 2013, we had an accumulated deficit of \$55.7 million. Changes in fair value of some of our common stock warrants have significantly impacted our results in recent periods. In particular, changes in the fair value of some of our common stock warrants accounted for a large portion of our losses in 2011 and 2010, whereas in 2012 and the first half of 2013 we recognized non-cash income as a result of the change in fair value of such warrants. Accounting rules require us to record certain of our warrants as a liability, measure the fair value of these warrants each quarter and record changes in that value in earnings. Consequently, we may be exposed to non-cash charges, or we may record non-cash income, as a result of this warrant exposure in future periods. During 2012 we borrowed additional funds and restructured certain of our outstanding debt obligations, and issued additional warrants to our debt holders. As a result of these borrowings and restructurings, we incurred a significant one-time, non-cash debt and warrant restructuring charge and increased interest expense in 2012 and may incur additional non-cash income or expense related to our outstanding warrants in future periods.

On April 10, 2013, we completed our IPO. In connection with the IPO, \$9.6 million of debt was converted into common stock at the IPO price of \$10.00 per share. In connection with the conversion of debt into common stock, we expensed the applicable remaining debt discounts of \$3.5 million, financing fees of \$419,000 and a contingently recognizable beneficial conversion feature in the converted debt of \$3.0 million. For the six months ended June 30, 2013, the change in the fair value of our warrant liability resulted in \$5.1 million in non-cash income. The fair market value of certain of our outstanding common stock warrants that we are required to account for as liabilities decreased during the six months ended June 30, 2013. The decrease principally resulted from a shareholder, Mr. John Pappajohn, limiting certain anti-dilution rights in his warrants to purchase shares of the Company s common stock resulting in a lower fair value of the warrant liability and non-cash income during this period.

**Key Factors Affecting our Results of Operations and Financial Condition**

Our overall long-term growth plan is predicated on our ability to develop and commercialize our proprietary tests outside of our clinical laboratory and to increase comprehensive oncology testing volumes in our laboratory. We launched MatBA<sup>®</sup>-CLL in the first quarter 2011 for use in our clinical laboratory, we received CLIA approval for MatBA<sup>®</sup>-SLL in January 2012, we received CLIA approval for MatBA<sup>®</sup>-DLBCL in February 2013, we commercially launched UroGenRA<sup>™</sup> in May 2013 for use in our clinical laboratory and we are developing additional proprietary tests. In order to market our tests to independent laboratories and testing facilities, we believe we will need to obtain approvals or clearances from the appropriate regulatory authorities, including FDA. Without these approvals, the success of these commercialization efforts will be limited. To obtain these approvals and facilitate market adoption of our proprietary tests, we anticipate having to successfully complete additional studies with clinical samples and publish our results in peer-reviewed scientific journals. Our ability to complete such studies is dependent upon our ability to leverage our collaborative relationships with leading institutions to facilitate our research and obtain data for our quality assurance and test validation efforts.

We believe that the factors discussed in the following paragraphs have had and are expected to continue to have a material impact on our results of operations and financial condition.

***Revenues***

Our revenue in 2012 was generated principally through our clinical laboratory services, with approximately 13% of our revenue from government research grants such as the National Cancer Institute, and approximately 2% of our revenue from sales of our DNA probes, which are only sold outside the United States. The clinical laboratory industry is highly competitive, and our relationship with the decision-maker at hospitals, cancer centers or physician offices is a critical component of securing their business. Consequently, our ability to attract and maintain

productive sales personnel that have and can grow these relationships will largely

**Table of Contents**

determine our ability to grow our clinical services revenue. In order to grow our clinical laboratory revenue, we must continue to pursue validation studies and work with oncology thought leaders to develop data that is helpful in supporting the need for our tests and services.

Due to the early stage nature of our business and our limited sales and marketing activities to date, we have historically derived a significant portion of our revenue from a limited number of test ordering sites, although the test ordering sites that generate a significant portion of our revenue have changed from period to period. Our test ordering sites are largely hospitals, cancer centers, reference laboratories and physician offices, as well as biopharmaceutical companies as part of a clinical trial. Oncologists and pathologists at these sites order the tests on behalf of the needs of their oncology patients or as part of a clinical trial sponsored by a biopharmaceutical company in which the patient is being enrolled. For the year ended 2012, our top five test ordering sites accounted for 58% of our clinical testing volume with approximately 46% of the volume coming from community hospitals. For the year ended December 31, 2011, our top five test ordering sites represented approximately 63% of our clinical testing volume, with approximately 29% of the volume coming from community hospitals. For the year ended December 31, 2011, we generated revenue from two test ordering sites that represented 10% or more of our revenue: a community hospital accounted for approximately 18% of our revenue and a community oncology practice accounted for approximately 11% of our revenue. For the year ended December 31, 2012, three test ordering sites accounted for 10% or more of our revenue; a university teaching center accounted for approximately 11%; a clinical trial client accounted for approximately 13% and a community hospital accounted for approximately 10%. The loss of any one of these test ordering sites would not materially adversely affect our results of operations. The top five test ordering sites during the six months ended June 30, 2013 and 2012 accounted for 69% and 61%, respectively, of our clinical testing volumes, with 27% and 48%, respectively, of the volume coming from community hospitals. During the six months ended June 30, 2013, there was one site which accounted for more than 10% of our revenue: a clinical trial client accounted for approximately 38% of our revenue. During the six months ended June 30, 2012, there were four sites which each accounted for approximately 10% or more of our clinical revenue: a university teaching center accounting for approximately 17%; a community hospital accounted for approximately 12%, and; a clinical trial client and a community hospital network each accounted for approximately 11%. The top five test ordering sites during the three months ended June 30, 2013 and 2012 accounted for 74% and 62% respectively, of our clinical testing volumes, with 23% and 52% respectively, of the volume coming from community hospitals. During the three months ended June 30, 2013, there was one site which accounted for more than 10% of our revenue: a clinical trial client accounted for approximately 50% of our revenue. During the three months ended June 30, 2012, there were three sites which each accounted for 10% or more of our clinical revenue: a university teaching center accounting for approximately 13%, a community hospital accounted for approximately 11%, and a community hospital network accounted for approximately 11%.

We receive revenue for our clinical laboratory services from private insurance carriers and other non-Medicare payors (such as unions and self-insured plans), Medicare, direct bill customers, and grants. Direct bill customers are institutions that choose, generally at the beginning of our relationship, to pay for our laboratory services directly, as opposed to having patients (or their insurers) pay for those services and providing us with the patients' insurance information. For instance, bio-pharmaceutical companies generally are direct bill customers. A hospital may elect to be a direct bill customer, and pay our bills directly, or may provide us with patient information so that their patients pay our bills, in which case we generally look to payment from their private insurance carrier or Medicare. In a few instances, we have arrangements where a hospital may have two accounts with us, so that certain tests are direct billed to the hospital, and certain tests are billed to and paid by a patient's insurer. The billing arrangements generally are dictated by our customers and in accordance with state and federal law. In 2012, private insurance accounted for approximately 30% of our total revenue, Medicare accounted for approximately 18% of our total revenue, direct bill clients accounted for 37% of our total revenue and the balance of our revenue was attributable to grants and sales of our DNA probes. In 2011, private insurance accounted for approximately 51% of our total revenue, Medicare accounted for approximately 24% of our total revenue, direct-bill clients comprised approximately 12% of our total revenue and the balance of our revenue was attributable to grants and sales of our DNA probes. As we expand our portfolio of tests and services, our sales activities and our ExpandDX program, we expect the percentage of revenue from direct-bill customers may decrease over the long term. However, during 2012 we started working with a community hospital that preferred the direct bill model and a new direct bill clinical trial services customer, which resulted in a significant increase in direct bill customers as a percentage of revenue for 2012. It is too early in our development to predict whether our experience during 2012 indicates a reversal in the trend we had seen in prior years or simply a variation as we attempt to expand our business and introduce new community hospitals, regional laboratories or clinical trial services customers in a particular period. On average, we generate less revenue per test from direct-bill customers than from other third-party payors but we also have reduced sales cost associated with direct bill clients and significantly reduced collections risk from direct-bill customers and have not experienced any significant collection issues or expenses as a result. Typically, we negotiate discounts in the range of 5% to 20% with direct bill clients depending on the volume of business in a twelve month period.

***Cost of Revenues***

Our cost of revenues consists principally of internal personnel costs, including stock-based compensation, laboratory consumables, shipping costs, overhead and other direct expenses, such as specimen procurement and third party validation studies. We are pursuing various strategies to reduce and control our cost of revenues, including automating our processes through more efficient technology, attempting to negotiate improved terms with our suppliers and exploring relocating our manufacturing operations to a lower cost-base country.



**Table of Contents****Operating Expenses**

We classify our operating expenses into three categories: research and development, sales and marketing, and general and administrative. Our operating expenses principally consist of personnel costs, including stock-based compensation, outside services, laboratory consumables and overhead, development costs, marketing program costs and legal and accounting fees.

*Research and Development Expenses.* We incur research and development expenses principally in connection with our efforts to develop our proprietary tests. Our primary research and development expenses consist of direct personnel costs, laboratory equipment and consumables and overhead expenses. We anticipate that research and development expenses will increase in the near-term, principally as a result of hiring additional personnel to develop and validate tests in our pipeline and to perform work associated with our research collaborations. In addition, we expect that our costs related to collaborations with research and academic institutions will increase. For example, we recently entered into an affiliation agreement to form a joint venture with the Mayo Foundation for Medical Education and Research. All research and development expenses are charged to operations in the periods they are incurred.

*Sales and Marketing Expenses.* Our sales and marketing expenses consist principally of personnel and related overhead costs for our sales team and their support personnel, travel and entertainment expenses, and other selling costs including sales collaterals and trade shows. We expect our sales and marketing expenses to increase significantly after we complete our initial public offering as we expand into new geographies and add new clinical tests and services.

*General and Administrative Expenses.* General and administrative expenses consist principally of personnel-related expenses, professional fees, such as legal, accounting and business consultants, occupancy costs, bad debt and other general expenses. We expect that our general and administrative expenses will increase as we expand our business operations. We further expect that general and administrative expenses will increase significantly due to increased information technology ( IT ), legal, insurance, accounting and financial reporting expenses associated with being a public company.

**Seasonality**

Our business experiences decreased demand during spring vacation season, summer months and the December holiday season when patients are less likely to visit their health care providers. We expect this trend in seasonality to continue for the foreseeable future.

**Results of Operations****Three Months Ended June 30, 2013 and 2012**

The following table sets forth certain information concerning our results of operations for the periods shown:

	Three Months Ended June 30,		Change	
	2013	2012	\$	%
<i>(dollars in thousands)</i>				
Revenue	\$ 1,832	\$ 1,148	\$ 684	60%
Cost of revenues	1,279	1,086	193	18%
Research and development expenses	456	527	(71)	(13%)
Sales and marketing expenses	447	376	71	19%
General and administrative expenses	1,384	1,393	(9)	(1%)
<b>Total Operating Loss</b>	<b>(1,734)</b>	<b>(2,234)</b>	<b>500</b>	<b>(22%)</b>
Interest expense, net	(388)	(1,082)	694	64%
Debt conversion costs	(6,850)		(6,850)	n/a
Change in fair value of warrant liability	(170)	1,456	(1,626)	(112%)
<b>Loss before income taxes</b>	<b>(9,142)</b>	<b>(1,860)</b>	<b>(7,282)</b>	<b>392%</b>
Income tax (benefit) expense				

Edgar Filing: CANCER GENETICS, INC - Form 10-Q

<b>Net Loss</b>	<b>\$ (9,142)</b>	<b>\$ (1,860)</b>	<b>\$ (7,282)</b>	<b>392%</b>
-----------------	-------------------	-------------------	-------------------	-------------

**Revenue**

Revenue increased 60%, or \$684,000, to \$1.8 million for the three months ended June 30, 2013, from \$1.1 million for the three months ended June 30, 2012, primarily due to an increase in test volume. Our average revenue (excluding grant revenue and probe revenue) per test decreased by 4% to \$557 per test for the three months ended June 30, 2013, from \$581 per test for the three months ended June 30, 2012, principally due to a decrease in the average revenue per test for tests reimbursed under Medicare. Our test volume increased by 97% to 3,204 for the three months ended June 30, 2013, from 1,623 for the three months ended June 30, 2012 due to an increase in tests performed for a significant clinical trials client. Grant revenue decreased \$184,500 to \$0 for the three months ended June 30, 2013, from the three months ended June 30, 2012, due to the completion of scheduled drawdowns. MatBA<sup>®</sup> revenue for the three months ended June 30, 2013 was \$265,000 or 14% of revenue, compared to \$27,000 or 2% of revenue for the three months ended June 30, 2012.

**Table of Contents**

Revenue from private insurance carriers and other non-Medicare payors increased 23%, or \$76,000, to \$405,000 for the three months ended June 30, 2013, from \$330,000 for the three months ended June 30, 2012, principally due to an increase in testing volume. Revenue from private insurance carriers and other non-Medicare payors as a percentage of total revenue decreased to 22% of total revenue for the three months ended June 30, 2013, from 29% of total revenue for the three months ended June 30, 2012. Revenue from DNA probe sales by CGI Italia increased 139%, or \$28,000, to \$48,000 for the three months ended June 30, 2013, from \$20,000 for the three months ended June 30, 2012, principally due to an increase in sales volume. Revenue from Medicare decreased 44%, or \$119,000, to \$151,000 for the three months ended June 30, 2013, from \$270,000 for the three months ended June 30, 2012, principally due to a delay in finalizing and publishing the updated fee schedule by Medicare for molecular tests as well as a decline in average revenue per test reimbursed under Medicare. Revenue from Medicare as a percentage of total revenue decreased to 8% for the three months ended June 30, 2013, from 23% for the three months ended June 30, 2012. Revenue from direct bill customers increased 257%, or \$883,000, to \$1.2 million for the three months ended June 30, 2013, from \$344,000 for the three months ended June 30, 2012, principally due to an increase in revenue from a significant clinical trial client. Revenue from direct bill customers as a percentage of total revenue increased to 67% for the three months ended June 30, 2013, from 30% for the three months ended June 30, 2012.

***Cost of Revenues***

Cost of revenues increased 18%, or \$193,000, to \$1.3 million for the three months ended June 30, 2013, from \$1.1 million for the three months ended June 30, 2012, principally due to clinical supply costs related to higher test volumes. However, due to scaling efficiencies associated with performing a large amount of tests for a significant clinical trials client, costs did not increase proportionately relative to the increase in revenues.

***Operating Expenses***

*Research and Development Expenses.* Research and development expenses decreased 13%, or \$71,000, to \$456,000 for the three months ended June 30, 2013, from \$527,000 for the three months ended June 30, 2012, principally as a result of a decrease in non-employee stock-based compensation related expenses of \$102,000 and a decrease of \$69,000 in employee compensation related expenses, both of which were partially offset by an increase in supplies expense of \$102,000.

*Sales and Marketing Expenses.* Sales and marketing expenses increased 19%, or \$71,000, to \$447,000 for the three months ended June 30, 2013, from \$376,000 for the three months ended June 30, 2012, principally due to an increase in headcount and compensation-related costs.

*General and Administrative Expenses.* General and administrative expenses remained relatively unchanged at \$1.4 million for each of the three month periods ended June 30, 2013 and June 30, 2012, respectively.

***Interest Income and Expense***

Interest expense decreased 64%, or \$694,000, to \$388,000 for the three months ended June 30, 2013, from \$1.1 million for the three months ended June 30, 2012. The decrease is attributable to the conversion of \$9.6 million of debt into common stock which occurred concurrently with our IPO on April 10, 2013.

***Debt Conversion Costs***

On April 10, 2013, we completed our IPO. In connection with the IPO, \$9.6 million of debt was converted into common stock at the IPO price of \$10.00 per share. In connection with the conversion of debt into common stock, we expensed the applicable remaining debt discounts of \$3.5 million, financing fees of \$419,000 and a contingently recognizable beneficial conversion feature in the converted debt of \$3.0 million, the total of which resulted in a \$6.9 million write-off.

***Change in Fair Value of Warrant Liability***

The change in the fair value of our warrant liability resulted in \$170,000 in non-cash expense for the three months ended June 30, 2013, as compared to non-cash income of \$1.5 million for the three months ended June 30, 2012. Certain of our outstanding common stock warrants, which we are required to account for as liabilities, are re-valued each quarter at amounts that correspond with changes in the value of our common stock. Concurrent with the IPO date of April 10, 2013, derivative warrants with a fair value of \$7.2 million were reclassified into equity due to the lapsing of anti-dilution provisions in the warrants. Since the re-classification, future changes in the value of these particular warrants are no longer required to be recorded in our financial statements. Also since the re-classification, there are significantly less warrants that are subject to revaluation each quarter. During the three months ended June 30, 2013, the fair market value of the 125,164 remaining common stock

Edgar Filing: CANCER GENETICS, INC - Form 10-Q

warrants that are subject to revaluation increased as a consequence of an increase in our stock price and resulted in \$170,000 of non-cash expense during this period.

**Table of Contents**

During the three months ended June 30, 2012, the fair market value of these common stock warrants decreased as a consequence of a decrease in our assumed stock price and resulted in \$1.5 million of non-cash income during this period.

**Results of Operations****Six Months Ended June 30, 2013 and 2012**

The following table sets forth certain information concerning our results of operations for the periods shown:

	<b>Six Months Ended June 30,</b>		<b>Change</b>	
	<b>2013</b>	<b>2012</b>	<b>\$</b>	<b>%</b>
<i>(dollars in thousands)</i>				
Revenue	\$ 3,050	\$ 1,983	\$ 1,067	54%
Cost of revenues	2,349	1,909	440	23%
Research and development expenses	951	1,050	(99)	(9%)
Sales and marketing expenses	832	716	116	16%
General and administrative expenses	2,961	2,329	632	27%
<b>Total Operating Loss</b>	<b>(4,043)</b>	<b>(4,021)</b>	<b>(22)</b>	<b>(1%)</b>
Interest expense, net	(1,682)	(1,948)	266	(14%)
Debt conversion costs	(6,850)		(6,850)	n/a
Change in fair value of warrant liability	5,129	3,036	2,093	69%
<b>Loss before income taxes</b>	<b>(7,446)</b>	<b>(2,933)</b>	<b>4,513</b>	<b>154%</b>
Income tax (benefit) expense	(664)		(664)	n/a
<b>Net loss</b>	<b>\$ (6,782)</b>	<b>\$ (2,933)</b>	<b>\$ (3,849)</b>	<b>131%</b>

**Revenue**

Revenue increased 54%, or \$1.1 million, to \$3.1 million for the six months ended June 30, 2013, from \$2.0 million for the six months ended June 30, 2012, due to an increase in test volume and average revenue per test. Our average revenue (excluding grant revenue and probe revenue) per test increased by 7% to \$578 per test for the six months ended June 30, 2013, from \$542 per test for the six months ended June 30, 2012, principally due to an increase in the average revenue per test attributable to clinical trial services. Our test volume increased by 58% to 5,115 for the six months ended June 30, 2013, from 3,233 for the six months ended June 30, 2012 principally due to an increase in tests performed for a significant clinical trials client. Grant revenue decreased \$195,000 to \$0 for the six months ended June 30, 2013, from the six months ended June 30, 2012, due to the completion of scheduled drawdowns. MatBA<sup>®</sup> revenue for the six months ended June 30, 2013 was \$397,000 or 13% of revenue, compared to \$119,000 or 6% of revenue for the six months ended June 30, 2012.

Revenue from direct bill customers increased 154%, or \$1.1 million, to \$1.7 million for the six months ended June 30, 2013, from \$684,000 for the six months ended June 30, 2012, principally due to an increase in revenue from a significant clinical trials client. Revenue from direct bill customers as a percentage of total revenue increased to 57% for the six months ended June 30, 2013, from 35% for the six months ended June 30, 2012. Revenue from private insurance carriers and other non-Medicare payors increased 23%, or \$152,000, to \$812,000 for the six months ended June 30, 2013, from \$660,000 for the six months ended June 30, 2012, principally due to an increase in testing volume. Revenue from private insurance carriers and other non-Medicare payors as a percentage of total revenue decreased to 27% of total revenue for the six months ended June 30, 2013, from 33% of total revenue for the six months ended June 30, 2012. Revenue from DNA probe sales by CGI Italia increased 163%, or \$57,000, to \$92,000 for the six months ended June 30, 2013, from \$35,000 for the six months ended June 30, 2012, principally due to an increase in sales volume. Revenue from Medicare remained relatively constant at \$408,000 for the six months ended June 30, 2013 and \$409,000 for the six months ended June 30, 2012, principally due to a higher number of Medicare reimbursed tests, offset by a decrease in average revenue per test reimbursed under Medicare. Revenue from Medicare as a percentage of total revenue decreased to 13% for the six months ended June 30, 2013, from 21% for the six months ended June 30, 2012.

**Cost of Revenues**

## Edgar Filing: CANCER GENETICS, INC - Form 10-Q

Cost of revenues increased 23%, or \$440,000, to \$2.3 million for the six months ended June 30, 2013, from \$1.9 million for the six months ended June 30, 2012, principally due to clinical supply costs related to higher test volumes. However, due to scaling efficiencies associated with performing a large amount of tests for a clinical trials client, costs did not increase proportionately relative to the increase in revenues.

---

## **Table of Contents**

### ***Operating Expenses***

*Research and Development Expenses.* Research and development expenses decreased 9%, or \$99,000, to \$951,000 for the six months ended June 30, 2013, from \$1.1 million for the six months ended June 30, 2012, principally as a result of a decrease in non-employee stock-based compensation related expenses of \$207,000 and a decrease of \$96,000 in employee compensation related expenses, both of which were partially offset by an increase in supplies expense of \$209,000.

*Sales and Marketing Expenses.* Sales and marketing expenses increased 16%, or \$116,000, to \$832,000 for the six months ended June 30, 2013, from \$716,000 for the six months ended June 30, 2012, principally due to an increase in headcount and compensation-related costs.

*General and Administrative Expenses.* General and administrative expenses increased 27%, or \$632,000 to \$3.0 million for the six months ended June 30, 2013, from \$2.3 million for the six months ended June 30, 2012, principally due to the write-off of \$618,000 of deferred IPO costs and an increase of \$327,000 in compensation and headcount-related expenses (including IPO bonuses and stock-based compensation) during 2013 offset by a decrease of \$350,000 for the legal settlement which was recorded during the same period in the prior year.

### ***Interest Income and Expense***

Interest expense decreased 14%, or \$266,000, to \$1.7 million for the six months ended June 30, 2013, from \$1.9 million for the six months ended June 30, 2012. The decrease is attributable to the conversion of \$9.6 million of debt into common stock which occurred concurrently with the closing of our IPO on April 10, 2013.

### ***Debt Conversion Costs***

On April 10, 2013, we completed our IPO. In connection with the IPO, \$9.6 million of debt was converted into common stock at the IPO price of \$10.00 per share. In connection with the conversion of debt into common stock, we expensed the applicable remaining debt discounts of \$3.5 million, financing fees of \$419,000 and a contingently recognizable beneficial conversion feature in the converted debt of \$3.0 million, the total of which resulted in a \$6.9 million write-off.

### ***Change in Fair Value of Warrant Liability***

The change in the fair value of our warrant liability resulted in \$5.1 million in non-cash income for the six months ended June 30, 2013, as compared to non-cash income of \$3.0 million for the six months ended June 30, 2012. The fair market value of certain of our outstanding common stock warrants, that we are required to account for as liabilities, decreased during the period from December 31, 2012 through June 30, 2013, and principally resulted from a shareholder, Mr. John Pappajohn, limiting certain anti-dilution rights in his warrants to purchase shares of the Company's common stock, resulting in a lower fair value of the warrant liability and non-cash income during this period. Concurrent with the IPO on April 10, 2013, derivative warrants with a fair value of \$7.2 million were reclassified into equity due to the lapsing of anti-dilution provisions in the warrants. Since the re-classification, future changes in the value of these specific warrants are no longer required to be recorded in our financial statements although there are 125,164 warrants that are still subject to future revaluation.

During the six months ended June 30, 2012, the fair market value of these common stock warrants decreased as a consequence of a decrease in our stock price and resulted in \$3.0 million of non-cash income during this period.

### ***Income Taxes***

During the six months ended June 30, 2013, we received \$664,000 in cash for the sale of certain state NOL carryforwards.

### **Liquidity and Capital Resources**

#### ***Sources of Liquidity***

Our primary sources of liquidity have been funds generated from our debt financings and equity financings. In addition, we have generated funds from the following sources: (i) the grants received in lieu of federal income tax credits under the Qualifying Therapeutic Discovery Project Program; (ii) grants from the National Institutes of Health and (iii) cash payments generated from operations.

During January 2013, we received \$664,000 in cash in from sales of state NOL's.

## Edgar Filing: CANCER GENETICS, INC - Form 10-Q

On April 10, 2013, we sold 690,000 shares of common stock at a public offering price of \$10.00 per share and completed our IPO with net proceeds of \$5 million. Upon the closing of the IPO, all shares of our then-outstanding Series A and Series B convertible preferred stock automatically converted into an aggregate of 1,287,325 shares of common stock. Concurrent with the IPO, certain derivative warrants with a fair value of \$7.2 million were reclassified into equity due to the lapsing of anti-dilution provisions in the warrants. Also concurrent with the IPO, \$9.6 million of debt converted into 963,430 shares of common stock. Refer to Notes 1, 4 and 6 to the Consolidated Financial Statements accompanying this filing.

---

**Table of Contents**

On April 29, 2013, the Company received \$96,000 from shareholders who exercised warrants to purchase 24,000 shares of common stock at \$4.00 per share.

On July 8, 2013, the Company received \$96,000 from shareholders who exercised warrants to purchase 24,000 shares of common stock at \$4.00 per share.

Following our initial public offering, we have the following credit facilities outstanding:

*Wells Fargo Line of Credit.* In April 2008, we entered into and thereafter fully utilized a line of credit with Wells Fargo in the amount of \$1.5 million for the purposes of meeting operating expenses and working capital needs. In July 2008, we increased the line of credit with Wells Fargo to \$3.5 million. In March 2009, we increased the facility to \$4.5 million. In July 2009, we increased the facility to \$5.5 million and in October 2009, we increased the facility to \$6.0 million, which we have fully utilized. In July 2010, we extended the maturity date of the facility from July 31, 2010 to July 31, 2011. In June 2011, we extended the maturity date on the facility to July 31, 2012. In February 2012, we extended the maturity date of the facility to July 31, 2013. In October 2012, we extended the maturity date to April 1, 2014. The interest is computed at LIBOR + 1.75%, which was 2.0% as of December 31, 2012. Mr. Pappajohn, a member of our board of directors, has guaranteed the Wells Fargo Line of Credit.

*DAM Line of Credit.* In March 2011, we entered into, and since have fully utilized, a line of credit with DAM in the amount of \$3.0 million for the purposes of meeting operating expenses, including expenses related to our initial public offering process. As consideration, we paid an annual interest rate of 3% on the borrowed funds on a monthly basis and issued DAM warrants to purchase an aggregate of 60,000 shares of common stock at an exercise price of \$25.00 per share. Our interest rate under this line of credit increased to 10% per annum, effective January 1, 2012, because such maturity events, including completion of an initial public offering, did not occur before January 1, 2012. In March 2012, we extended the maturity date of this facility to April 1, 2013, unless certain maturity events occur prior to April 1, 2013, in exchange for a grant of 15,000 warrants on the same terms as those issued in the December 2011 Financing Transaction described below. On October 16, 2012, DAM Holdings agreed to surrender 15,000 warrants in exchange for a cash interest payment of \$52,500 at maturity. In addition, we amended the agreement to provide that the interest rate from January 1, 2012 until a maturity event occurs shall be 10%. After a maturity event occurs, interest begins to compound at a rate of 18% per annum until the balance is paid in full. On February 13, 2013, DAM agreed to convert \$1.0 million of outstanding principal amount due to DAM into an aggregate of 100,000 shares of common stock at our initial public offering price of \$10.00 per share. On March 19, 2013, DAM agreed to extend the maturity date of this facility to August 15, 2013.

*December 2011 Financing Transaction.* We entered into a Credit Agreement dated as of December 21, 2011, as amended and restated as of February 13, 2012, with John Pappajohn and Andrew Pecora (indirectly through an investment company), both members of our board of directors, and NNJCA Capital, LLC ( NNJCA ), a limited liability company of which Dr. Pecora is a member, for a \$6.0 million secured term loan. Mr. Pappajohn provided \$4.0 million of financing, NNJCA provided \$1.5 million of financing and Dr. Pecora provided \$500,000 of financing under the Credit Agreement.

The loan bears an annual interest rate equal to the prime rate plus 6.25% (9.50% at December 31, 2012) and matures on August 15, 2013. The loan is secured by all of our assets, including our intellectual property, subject to prior first and second liens in favor of Wells Fargo Bank and DAM. Pursuant to an intercreditor agreement, the lenders have agreed that all amounts due to DAM are to be paid prior to payment to the lenders under this Credit Agreement, but that as between such lenders, following an event of default, all of the security granted by us is to be applied first to repay obligations due to Dr. Pecora and NNJCA, and then to Mr. Pappajohn after they have been paid in full. As Mr. Pappajohn has guaranteed the Wells Fargo debt, in essence under the intercreditor agreement, NNJCA and Dr. Pecora will be junior only to DAM.

In addition, the warrants to purchase an aggregate of 37,646 shares of our common stock issued to Dr. Pecora and NNJCA in connection with this financing were cancelled and the promissory notes issued to Dr. Pecora and NNJCA were amended to increase the pre-payment penalties by \$130,000. On February 13, 2013, Mr. Pappajohn agreed to convert \$2.0 million of the outstanding principal amount to common stock at the initial public offering price per share upon consummation of our initial public offering and NNJCA agreed to convert \$500,000 of the outstanding principal amount due to NNJCA to common stock at the initial public offering price per share upon consummation of our initial public offering. As a result, an aggregate of \$1.5 million remained outstanding and payable to NNJCA and Dr. Pecora.

**Table of Contents**

In general, our primary uses of cash are providing for working capital purposes (which principally represent payroll costs, the purchase of supplies, rent expense and insurance costs) and servicing debt. As of June 30, 2013, we have outstanding borrowings of \$9.5 million. Our largest source of operating cash flow is cash collections from our customers.

***Cash Flows***

Our net cash flow from operating, investing and financing activities for the periods below were as follows:

<i>(in thousands)</i>	<b>Six Months Ended June 30</b>	
	<b>2013</b>	<b>2012</b>
	<b>(unaudited)</b>	
<b>Cash provided by (used in):</b>		
Operating activities	\$ (3,766)	\$ (4,102)
Investing activities	(124)	(226)
Financing activities	5,011	2,312
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>\$ 1,121</b>	<b>\$ (2,016)</b>

We had cash and cash equivalents of \$1.9 million at June 30, 2013, and \$820,000 at December 31, 2012.

The \$1.1 million increase in cash and cash equivalents for the six months ended June 30, 2013, was principally the result of the receipt of \$5.0 million in proceeds received in our IPO on April 10, 2013 offset by \$3.8 million of net cash used in operations.

The \$2.0 million decrease in cash and cash equivalents from December 31, 2011, to June 30, 2012, was principally the result of our \$5.4 million net cash used in operations offset by \$3.6 million in net proceeds from borrowings under new notes payable and warrant exercises.

At June 30, 2013, we had total indebtedness of \$9.5 million.

***Cash Used in Operating Activities***

Net cash used in operating activities was \$3.8 million for the six months ended June 30, 2013. We used \$3.5 million in net cash to run our core operations, which included \$490,000 in cash paid for interest. We incurred additional uses of cash as follows: \$336,000 for a net decrease in accounts payable, accrued expenses and deferred revenue; \$220,000 to increase other current assets which included prepayments for our insurance policies as well as prepayments for consumables and other supplies used to run our operations, and; accounts receivable increased by \$413,000. All of these uses of cash were partially offset by the receipt of \$664,000 from the sale of certain state NOL carryforwards in January, 2013.

Net cash used in operating activities was \$4.1 million for the six months ended June 30, 2012, and primarily consisted of a \$2.9 million net loss during the period and non-cash income from a change in fair value of warrant liability of \$3.0 million offset by non-cash debt costs of \$1.5 million.

***Cash Used in Investing Activities***

Net cash used in investing activities was \$124,000 for the six months ended June 30, 2013 and principally resulted from: an increase in our restricted cash related to a \$50,000 increase in the Letter of Credit related to our lease; purchases of fixed assets of \$43,000; and \$32,000 in patent application costs.

Net cash used in investing activities was \$226,000 for the six months ended June 30, 2012 due to an increase in our restricted cash related to a \$50,000 increase in the Letter of Credit related to our lease as well as \$149,000 in patent application costs.

***Cash Provided by Financing Activities***

## Edgar Filing: CANCER GENETICS, INC - Form 10-Q

Net cash provided by financing activities was \$5.0 million for the six months ended June 30, 2013, and primarily consisted of receipt of the proceeds raised in our IPO offset by the payment of \$1.9 million in offering costs, including \$637,000 in underwriting discounts, expenses and commissions, that were paid in the first half of 2013.

Net cash provided by financing activities was \$2.3 million for the six months ended June 30, 2012, principally due to our receipt of \$3.0 million in net proceeds from the December 2011 financing transaction which closed in February 2012 and \$620,000 in net proceeds from the exercise of certain warrants. We paid \$1.3 million in equity issuance costs related to our IPO in the six months ended June 30, 2012.

---

**Table of Contents**

***Capital Resources and Expenditure Requirements***

We expect to continue to incur substantial operating losses in the future. It may take several years, if ever, to achieve positive operational cash flow. Until we can generate a sufficient amount of revenues to finance our cash requirements, which we may never do, we will need to continue to raise additional capital to fund our operations.

We believe our current cash resources are sufficient to satisfy our liquidity requirements at our current level of operations through August 31, 2013 and then only if we are able to extend payment of \$3.5 million in outstanding indebtedness that matures on August 15, 2013. We need to raise additional financing immediately, through the proposed offering discussed below or otherwise, and over the next twelve months, to satisfy debt obligations and operate our business, which financing may not be available on favorable terms, or at all. We have had and will continue to have discussions with certain current and potential investors regarding potential additional financing in the event that such proposed offering is not consummated, but we can provide no assurances that any additional sources of financing will be available to us on favorable terms, or at all. If the proposed offering is not consummated, we must obtain an extension of the \$3.5 million indebtedness due August 15, 2013 and we would need to scale back our general and administrative activities and certain of our research and development activities. We can provide no assurances that we will be able to obtain an extension of the \$3.5 million indebtedness on favorable terms, or at all, or that any additional sources of financing will be available to us on favorable terms, or at all.

On June 5, 2013, we filed a registration statement on Form S-1 for a proposed public offering of \$15.0 million of our common stock. If we sell \$15.0 million of our common stock in this proposed offering, we estimate that our net proceeds from the proposed offering would be approximately \$13.5 million, or approximately \$15.6 million if the underwriters exercise their over-allotment option in full, after deducting estimated underwriting discounts and commissions and estimated offering expenses payable by us. We can provide no assurances that we will be able to sell shares of our common stock in the proposed offering on favorable terms or at all. We currently plan to use the net proceeds from this proposed offering to, among other things, repay the \$3.5 million of debt due on August 15, 2013 and make the initial \$1.0 million capital contribution due under our a joint venture with the Mayo Foundation for Medical Education and Research. (Such payment was due on July 31, 2013, and, while no assurances can be given, we believe Mayo will not declare a default and will extend the payment date.) With the anticipated net proceeds from the proposed offering, we believe our cash resources will then be sufficient to satisfy our liquidity requirements at our current level of operations through December 31, 2014, including any additional capital contributions to be made to Mayo, but assuming we can extend the \$6.0 million debt currently due to Wells Fargo on April 1, 2014. We have commenced negotiations with Wells Fargo and with Mr. Pappajohn, who serves as a guarantor for such outstanding indebtedness, to further extend the maturity date. However, there can be no assurances that we will be successful, and if we are not successful in obtaining an extension, we expect that we would need to raise additional financing in the first quarter of 2014, which might not be available on favorable terms, if at all. If we are unable to extend the Wells Fargo debt or secure additional financing, we would scale back our general and administrative activities and certain of our research and development activities. Our forecast of the period of time through which our current financial resources will be adequate to support our operations and the costs to support our general and administrative, sales and marketing and research and development activities are forward-looking statements and involve risks and uncertainties. Actual results could vary materially and negatively as a result of a number of factors, including:

our ability to secure financing and the amount thereof;

the timing of and the costs involved in obtaining regulatory approvals and clearances for our tests;

the costs of operating and enhancing our laboratory facilities;

if our new diagnostic tests are approved, our commercialization activities;

the scope, progress and results of our research and development programs;

the scope, progress, results, costs, timing and outcomes of the clinical trials of our diagnostic tests;

## Edgar Filing: CANCER GENETICS, INC - Form 10-Q

our ability to manage the costs for manufacturing our microarrays and probes;

the costs of maintaining, expanding and protecting our intellectual property portfolio, including potential litigation costs and liabilities;

our ability to obtain adequate reimbursement from governmental and other third-party payors for our tests and services;

revenues received from sales of our tests, if approved by FDA and accepted by the market;

the costs of additional general and administrative personnel, including accounting and finance, legal and human resources, as a result of becoming a public company;

the costs of developing our anticipated internal sales, marketing and distribution capabilities;

our ability to collect revenues; and

other risks discussed in the section entitled "Risk Factors" .

---

## **Table of Contents**

Even with the proceeds from the proposed offering, we will need to raise additional capital to expand our business to meet our long-term business objectives. We expect that our operating expenses and capital expenditures will increase in the future as we expand our business. We plan to increase our sales and marketing headcount to promote our new clinical tests and services and to expand into new geographies and to increase our research and development headcount to develop and validate the proprietary tests currently in our pipeline, to expand our pipeline and to perform work associated with our research collaborations. We also expect that our costs of collaborations with research and academic institutions will increase in the future as such institutions begin to view us as a commercial company. For example, in 2011 we entered into an affiliation agreement to form a joint venture with the Mayo Foundation for Medical Education and Research pursuant to which we expect to make capital contributions of up to \$6.0 million over the next three years, subject to negotiating an extension of that agreement, which negotiations have commenced, and the joint venture entity's achievement of certain operational milestones. Until we can generate a sufficient amount of revenues to finance our cash requirements, which we may never do, we will need to continue to raise additional capital to fund our operations.

We may raise additional capital to fund our current operations, to repay certain outstanding indebtedness and to fund expansion of our business to meet our long-term business objectives through public or private equity offerings, debt financings, borrowings or strategic partnerships coupled with an investment in our company or a combination thereof. If we raise additional funds through the issuance of convertible debt securities, or other debt securities, these securities could be secured and could have rights senior to those of our common stock. In addition, any new debt incurred by the Company could impose covenants that restrict our operations. The issuance of any new equity securities will also dilute the interest of our current stockholders. Given the risks associated with our business, including our unprofitable operating history and our ability to develop additional proprietary tests, additional capital may not be available when needed on acceptable terms, or at all. If adequate funds are not available, we will need to curb our expansion plans or limit our research and development activities, which would have a material adverse impact on our business prospects and results of operations.

### **Income Taxes**

Over the past several years we have generated operating losses in all jurisdictions in which we may be subject to income taxes. As a result, we have accumulated significant net operating losses and other deferred tax assets. Because of our history of losses and the uncertainty as to the realization of those deferred tax assets, a full valuation allowance has been recognized. We do not expect to report a provision for income taxes until we have a history of earnings, if ever, that would support the realization of our deferred tax assets.

### **Off-Balance Sheet Arrangements**

Since inception, we have not engaged in any off balance sheet activities as defined in Item 303(a)(4) of Regulation S-K.

### **Critical Accounting Policies and Significant Judgment and Estimates**

Our management's discussion and analysis of financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates based on historical experience and make various assumptions, which management believes to be reasonable under the circumstances, which form the basis for judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Section 107 of the JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. However, we are choosing to opt out of such extended transition period, and as a result, we will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. Section 107 of the JOBS Act provides that our decision to opt out of the extended transition period for complying with new or revised accounting standards is irrevocable.

The notes to our audited consolidated financial statements, which are included in our Prospectus, contain a summary of our significant accounting policies. We consider the following accounting policies critical to the understanding of the results of our operations:

Revenue recognition;

Accounts receivable and bad debts;

Stock-based compensation; and

Warrant liability.

## **Table of Contents**

### **Forward-Looking Statements**

Forward-looking statements include all statements that are not historical facts. In some cases, you can identify forward-looking statements by terms such as may, will, should, could, would, expects, plans, anticipates, believes, estimates, projects, predicts, those terms, and similar expressions and comparable terminology intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and subject to risks and uncertainties including those set forth below under Part II, Item 1A, Risk Factors in this quarterly report on Form 10-Q. Given these uncertainties, you should not place undue reliance on these forward-looking statements. These forward-looking statements represent our estimates and assumptions only as of the date of this quarterly report on Form 10-Q and, except as required by law, we undertake no obligation to update or review publicly any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this quarterly report on Form 10-Q. You should read this quarterly report on Form 10-Q and the documents referenced in this quarterly report on Form 10-Q and filed as exhibits completely and with the understanding that our actual future results may be materially different from what we expect. We qualify all of our forward-looking statements by these cautionary statements. Such statements may include, but are not limited to, statements concerning the following:

our ability to achieve profitability by increasing sales of our laboratory tests and services and to continually develop and commercialize novel and innovative genomic-based diagnostic tests and services for cancer patients;

our ability to raise additional capital to meet our liquidity short-term and long-term liquidity needs;

our ability to clinically validate our pipeline of genomic microarray tests currently in development;

our ability to execute on our marketing and sales strategy for our genomic tests and gain acceptance of our tests in the market;

our ability to keep pace with a rapidly advancing market;

our ability to satisfy U.S. (including FDA) and international regulatory requirements with respect to our tests and services, many of which are new and still evolving;

our ability to obtain reimbursement from governmental and other third-party payors for our tests and services;

competition from clinical laboratory services companies, genomic-based diagnostic tests currently available or new tests that may emerge;

our ability to maintain our clinical collaborations and enter into new collaboration agreements with highly regarded organizations in the cancer field so that, among other things, have access to thought leaders in the field and to a robust number of samples to validate our genomic tests;

our ability to maintain our present customer base and retain new customers;

potential product liability or intellectual property infringement claims;

## Edgar Filing: CANCER GENETICS, INC - Form 10-Q

our dependency on third-party manufacturers to supply or manufacture our products;

our ability to attract and retain a sufficient number of scientists, clinicians, sales personnel and other key personnel with extensive experience in oncology, who are in short supply;

our ability to obtain or maintain patents or other appropriate protection for the intellectual property in our proprietary tests and services;

our dependency on the intellectual property licensed to us or possessed by third parties;

our ability to expand internationally and launch our tests in emerging markets, such as India and Brazil; and

our ability to adequately support future growth

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Our exposure to market risk is limited to our cash, cash equivalents and marketable securities, all of which have maturities of one year or less. The goals of our investment policy are preservation of capital, fulfillment of liquidity needs and fiduciary control of cash and investments. We also seek to maximize income from our investments without assuming significant risk. To achieve our goals, we

## **Table of Contents**

maintain a portfolio of cash equivalents and investments in a variety of securities that management believes to be of high credit quality. The securities in our investment portfolio are not leveraged, are classified as available for sale and are, due to their short-term nature, subject to minimal interest rate risk. We currently do not hedge interest rate exposure. Because of the short-term maturities of our investments, we do not believe that an increase in market rates would have a material negative impact on the value of our investment portfolio.

We do not have any material foreign currency exposure.

### **Item 4. Controls and Procedures**

#### *Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Securities Exchange Act of 1934, as amended (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the issuer's management, including the principal executive officer and principal financial officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. As of June 30, 2013, we carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and our principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of June 30, 2013.

#### *Changes in Internal Control over Financial Reporting*

There were no changes in our internal control over financial reporting during the three months ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

---

**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

None.

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part II, Item 1A. Risk Factors in our Quarterly Report on Form 10-Q for the three months ended March 31, 2013, which could materially affect our business, financial condition or future results. The risks described in our Quarterly Report on Form 10-Q may not be the only risks facing the Company. Additional risks and uncertainties not currently known to the Company or that the Company currently deems to be immaterial also may materially adversely affect the Company's business, financial condition and/or operating results.

Except as set forth below, there were no material changes to the risk factors previously disclosed in our Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 15, 2013.

**Risks Relating to Our Business and Strategy**

*We need to raise additional capital immediately, and over the next twelve months, to satisfy debt obligations and to operate our business.*

We believe our current cash resources will be sufficient to satisfy our liquidity requirements at our current level of operations only through August 31, 2013 and then only if we are able to extend payment of \$3.5 million in outstanding indebtedness that matures on August 15, 2013. We need to raise additional financing in the near term, through the proposed offering or otherwise, to repay certain indebtedness and fund our current level of operations. Even if further extensions are obtained, we anticipate that we will need to secure additional financing to provide sufficient cash for normal operations. We also need to raise additional capital, through the proposed offering or otherwise, to make the payments of \$1.0 million due with respect to our joint venture with Mayo by each of July 31, 2013 and January 31, 2014 and to satisfy indebtedness of approximately \$6.0 million due on April 1, 2014. We have had discussions with Mayo to extend the July 31 payment, and, while no assurances can be given, we believe they will not declare a default and will agree to an extension. If Mayo were to declare us in default, it would materially and adversely impact our prospects. We also are seeking to extend the maturity of our indebtedness. If we are unable to extend the Wells Fargo debt or secure additional financing, we would scale back our general and administrative activities and certain of our research and development activities. We can provide no assurances that any additional sources of financing will be available to us on favorable terms, if at all. Our forecast of the period of time through which our current financial resources will be adequate to support our operations and the costs to support our general and administrative, sales and marketing and research and development activities are forward-looking statements and involve risks and uncertainties.

We will also need to raise additional capital to expand our business to meet our long-term business objectives. Additional financing, which is not in place at this time, may be from the sale of equity or convertible or other debt securities in a public or private offering, from an additional credit facility or strategic partnership coupled with an investment in us or a combination of both. We may be unable to raise sufficient additional financing on terms that are acceptable to us, if at all. Our failure to raise additional capital and in sufficient amounts may significantly impact our ability to expand our business. For further discussion of our liquidity requirements as they relate to our long-term plans, see the section entitled "Liquidity and Capital Resources - Capital Resources and Expenditure Requirements".

*A small number of test ordering sites account for most of the sales of our tests and services. If any of these sites orders fewer tests from us for any reason, our revenues could decline.*

Due to the early stage nature of our business and our limited sales and marketing activities to date, we have historically derived a significant portion of our revenue from a limited number of test ordering sites, although the test ordering sites that generate a significant portion of our revenue have changed from period to period. For example, there was one site which represented more than 10% of our revenue for the year ended December 31, 2010 that generated less than 10% of our revenue for the year ended December 31, 2011. Our test ordering sites are largely hospitals, cancer centers, reference laboratories and physician offices, as well as biopharmaceutical companies as part of a clinical trial. Oncologists and pathologists at these sites order the tests on behalf of the needs of their oncology patients or as part of a clinical trial sponsored by a biopharmaceutical company in which the patient is being enrolled. For the six months ended June 30, 2013 and 2012 our top five test order sites accounted for 69% and 61%, respectively, of our clinical testing volumes, with 27% and 48%, respectively, of the volume coming from

## Edgar Filing: CANCER GENETICS, INC - Form 10-Q

community hospitals. For the year ended December 31, 2012, our top five test ordering sites accounted for 58% of our clinical testing volume with approximately 46% of the volume coming from community hospitals. For the year ended December 31, 2011, our top five test ordering sites represented approximately 63% of our clinical testing volume, with approximately 29% of the volume coming from community hospitals.

**Table of Contents**

For the year ended December 31, 2011, we generated revenue from two test ordering sites that represented 10% or more of our revenue: a community hospital accounted for approximately 18% of our revenue and a community oncology practice accounted for approximately 11% of our revenue. For the year ended December 31, 2012, three test ordering sites accounted for 10% or more of our revenue; a university teaching center accounted for approximately 11%; a clinical trial client accounted for approximately 13% and a community hospital network accounted for approximately 10%. For the six months ended June 30, 2013, there was one site which accounted for more than 10% of our revenue: a clinical trial client accounted for approximately 38% of our revenue. For the six months ended June 30, 2012, there were four sites which each accounted for approximately 10% or more of our clinical revenue: a university teaching center accounting for approximately 17%; a community hospital accounted for approximately 12%; and a clinical trial client and a community hospital network each accounted for approximately 11%. The top five test ordering sites during the three months ended June 30, 2013 and 2012 accounted for 74% and 62% respectively, of our clinical testing volumes, with 23% and 52% respectively, of the volume coming from community hospitals. During the three months ended June 30, 2013, there was one site which accounted for more than 10% of our revenue: a clinical trial client accounted for approximately 50% of our revenue. During the three months ended June 30, 2012, there were three sites which each accounted for 10% or more of our clinical revenue: a university teaching center accounting for approximately 13%, a community hospital accounted for approximately 11%, and a community hospital network accounted for approximately 11%. We generally do not have formal, long-term written agreements with such test ordering sites, and, as a result, we may lose these significant test ordering sites at any time.

***We may acquire other businesses or form joint ventures or make investments in other companies or technologies that could harm our operating results, dilute our stockholders' ownership, increase our debt or cause us to incur significant expense.***

As part of our business strategy, we may pursue acquisitions of businesses and assets. We also may pursue strategic alliances and joint ventures that leverage our core technology and industry experience to expand our offerings or distribution. For example, we entered into a joint venture in May 2013 with Mayo Foundation for Education and Research. We have no experience with acquiring other companies and limited experience with forming strategic alliances and joint ventures. We may not be able to find suitable partners or acquisition candidates, and we may not be able to complete such transactions on favorable terms, if at all. If we make any acquisitions, we may not be able to integrate these acquisitions successfully into our existing business, and we could assume unknown or contingent liabilities. Any future acquisitions also could result in significant write-offs or the incurrence of debt and contingent liabilities, any of which could have a material adverse effect on our financial condition, results of operations and cash flows. Integration of an acquired company also may disrupt ongoing operations and require management resources that would otherwise focus on developing our existing business. We may experience losses related to investments in other companies, which could have a material negative effect on our results of operations. We may not identify or complete these transactions in a timely manner, on a cost-effective basis, or at all, and we may not realize the anticipated benefits of any acquisition, technology license, strategic alliance or joint venture.

To finance any acquisitions or joint ventures, we may choose to issue shares of our common stock as consideration, which would dilute the ownership of our stockholders. If the price of our common stock is low or volatile, we may not be able to acquire other companies or fund a joint venture project using our stock as consideration. Alternatively, it may be necessary for us to raise additional funds for acquisitions through public or private financings. Additional funds may not be available on terms that are favorable to us, or at all.

***Our agreement with Mayo may not proceed successfully.***

In November 2011, we entered into an affiliation agreement with the Mayo Foundation for Medical Education and Research, subsequently amended. Under the agreement, we formed a joint venture in May 2013 to focus on developing oncology diagnostic services and tests utilizing next generation sequencing. The agreement requires an initial \$1.0 million capital contribution by us by July 31, 2013, which we have not made. Although no assurances can be given, from conversations with Mayo we believe it will not declare a default and will extend the July 31 due date. The agreement also requires aggregate total capital contributions by us of up to \$6.0 million over the next three years, with \$4.0 million of such amount subject to the joint venture achieving certain operational milestones. The operation of the joint venture may also divert management time from operating our business. No assurances can be given that we will be able to fully fund the joint venture agreement, or that, even if funded, the joint venture will ever achieve the research, development and commercial objectives currently contemplated by the parties, such as the discovery and commercialization of new diagnostic tests utilizing next-generation sequencing. If the development efforts of the joint venture do not result in commercially successful tests or services, it will have an adverse effect on our business, financial condition and results of operations.

***We will need to raise additional capital immediately and over the next twelve months to repay indebtedness, to fund our existing operations and to develop and commercialize new tests and technologies and expand our operations.***

We need to raise additional capital immediately, through the proposed offering or otherwise, to repay approximately \$3.5 million in outstanding indebtedness that matures on August 15, 2013. Even if such indebtedness were further extended, we need to secure additional financing to provide cash for normal operations in the near term. We also need to raise additional capital to satisfy indebtedness of approximately \$6.0

## Edgar Filing: CANCER GENETICS, INC - Form 10-Q

million due to Wells Fargo on April 1, 2014. If we are unable to extend the Wells Fargo debt or secure additional financing, we would scale back our general and administrative activities and certain of our research and development activities. Additionally, we will need to raise capital to expand our business to meet our long-term business objectives, including to:

increase our sales and marketing efforts to drive market adoption and address competitive developments;

fund development and marketing efforts of any future tests;

**Table of Contents**

further expand our clinical laboratory operations;

expand our technologies into other types of cancer;

acquire, license or invest in technologies;

acquire or invest in complementary businesses or assets;

fund our subsequent contributions of at least \$1.0 million and up to \$5.0 million to our joint venture with Mayo if our joint venture with Mayo achieves certain operational milestones; and

finance capital expenditures and general and administrative expenses.

Our present and future funding requirements will depend on many factors, including:

our ability to achieve revenue growth;

our rate of progress in establishing reimbursement arrangements with domestic and international third-party payors;

the cost of expanding our laboratory operations and offerings, including our sales and marketing efforts;

our rate of progress in, and cost of the sales and marketing activities associated with, establishing adoption of and reimbursement for our microarray tests and probes;

our rate of progress in, and cost of research and development activities associated with, products in research and early development;

the effect of competing technological and market developments;

costs related to international expansion; and

the potential cost of and delays in test development as a result of any regulatory oversight applicable to our tests.

The various ways we could raise additional capital carry potential risks. If we raise funds by issuing equity securities, dilution to our stockholders could result. Any equity securities issued also could provide for rights, preferences or privileges senior to those of holders of our common stock. If we raise funds by issuing debt securities, those debt securities would have rights, preferences and privileges senior to those of holders of our common stock. The terms of debt securities issued or borrowings pursuant to a credit agreement could impose significant restrictions on our operations. If we raise funds through collaborations and licensing arrangements, we might be required to relinquish significant rights to our technologies or tests, or grant licenses on terms that are not favorable to us.

## Edgar Filing: CANCER GENETICS, INC - Form 10-Q

The credit markets and the financial services industry have experienced a period of unprecedented turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States federal government. These events have generally made equity and debt financing more difficult to obtain. Accordingly, additional equity or debt financing might not be available on reasonable terms, if at all. If we cannot secure additional funding when needed, we may have to delay, reduce the scope of or eliminate one or more research and development programs or sales and marketing initiatives. In addition, we may have to work with a partner on one or more of our development programs, which could lower the economic value of those programs to us.

*Some of our contract manufacturers and distributors are located outside of the United States, which may subject us to increased complexity and costs.*

We rely on manufacturing facilities located outside the United States for our probes, particularly in India. We also utilize distributors to sell probes outside the United States. Our probe manufacturing and international sales may be subject to certain risks, including:

difficulty in obtaining, maintaining or enforcing intellectual property rights in some countries;

local business and cultural factors that differ from our normal standards and practices;

foreign currency exchange fluctuations;

different regulatory requirements;

impediments to the flow of foreign exchange capital payments and receipts due to exchange controls instituted by certain foreign governments and the fact that local currencies of some countries are not freely convertible;

geopolitical and economic instability and military conflicts;

**Table of Contents**

difficulties in managing international distributors;

burdens of complying with a variety of foreign laws and treaties and changes in local laws and regulations, including tax laws;

difficulty in enforcing agreements, judgments and arbitration awards in foreign jurisdictions; and

adverse economic conditions in any jurisdiction.

## **Table of Contents**

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds from Sales of Registered Securities**

#### **Recent Sales of Unregistered Securities**

On April 29, 2013, the Company received \$96,000 from shareholders who exercised warrants to purchase 24,000 shares of common stock at \$4.00 per share.

#### **Use of Proceeds**

In connection with our IPO, we offered and sold 690,000 shares of common stock (including the over allotment option) at a price of \$10.00 per share. The offer and sale of the shares in the initial public offering were registered under the Securities Act of 1933, as amended, pursuant to a registration statement on Form S-1 effective on April 4, 2013. The underwriters in the offering were Aegis Capital Corp and Feltl and Company. After deducting underwriting discounts and commissions, transaction fees and offering related expenses not previously paid, our net proceeds from the initial public offering (including the over allotment option) were approximately \$5 million.

In connection with the offering, we paid underwriting discounts, expenses and commissions of approximately \$637,000, and paid approximately \$1.3 million in offering expenses.

From the date of our IPO until June 30, 2013, we used approximately \$3.2 million of the net proceeds from our IPO to fund our cash losses from operations and approximately \$100,000 for investing activities, including a \$50,000 increase in a deposit for our landlord.

### **Item 3. Defaults Upon Senior Securities**

None.

### **Item 4. Mine Safety Disclosures**

None.

### **Item 5. Other Information**

None.

### **Item 6. Exhibits**

See the Index to Exhibits immediately following the signature page hereto, which Index to Exhibits is incorporated herein by reference.

**Table of Contents**

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**Cancer Genetics, Inc.**  
(Registrant)

Date: August 5, 2013

**/s/ Panna L. Sharma**  
**Panna L. Sharma**  
**President and Chief Executive Officer**

**(Duly authorized signatory)**

Date: August 5, 2013

**/s/ Elizabeth Czerepak**  
**Elizabeth Czerepak**  
**Chief Financial Officer**

**(Principal Financial and Accounting Officer)**

**Table of Contents**

**INDEX TO EXHIBITS**

<b>Exhibit No.</b>	<b>Description</b>
3.1	Amended and Restated Certificate of Incorporation of the Cancer Genetics, Inc. (incorporated by reference to Exhibit 3.1 of the Company's Quarterly Report on form 10-Q, originally filed on May 14, 2013 with the Securities and Exchange Commission).
3.2	Amended and Restated Bylaws of Cancer Genetics, Inc. (incorporated by reference to Exhibit 3.4 of the Company's Registration Statement on Form S-1, as amended, originally filed on December 30, 2011 with the Securities and Exchange Commission).
10.1	Amendment No. 3 to Affiliation Agreement between the Company and Mayo Foundation for Medical Education and Research, dated May 21, 2013 (incorporated by reference to Exhibit 10.73 of the Company's Registration Statement on Form S-1, as amended, originally filed on June 5, 2013 with the Securities and Exchange Commission).
10.2	Limited Liability Company Agreement of OncoSpire Genomics, LLC, dated May 21, 2013 (incorporated by reference to Exhibit 10.74 of the Company's Registration Statement on Form S-1, as amended, originally filed on June 5, 2013 with the Securities and Exchange Commission).
10.3	Joint Development Intellectual Property Agreement, among the Company, Mayo Foundation for Medical Education and Research and OncoSpire Genomics, LLC, dated May 21, 2013 (incorporated by reference to Exhibit 10.75 of the Company's Registration Statement on Form S-1, as amended, originally filed on June 5, 2013 with the Securities and Exchange Commission).
31.1	Certification of Principal Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under The Securities Exchange Act of 1934, as amended
31.2	Certification of Principal Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under The Securities Exchange Act of 1934, as amended
32.1	Certifications of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002
32.2	Certifications of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002
101	The following materials from the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheet at December 31, 2012 and June 30, 2013 (unaudited), (ii) Consolidated Statements of Operations and Comprehensive Loss for the three and six month periods ended June 30, 2012 and 2013, (iii) Consolidated Statements of Cash Flows for the six month periods ended June 30, 2012 and 2013 (unaudited) and (iv) Notes to Consolidated Financial Statements (unaudited)