

## Neoprobe Corporation

OTC: BB-NEOP- \$0.50

www.neoprobe.com

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### Initial Report

### Poised to Benefit from Proprietary Cancer Detection Technology and Strategic Marketing Alliance

Current Data		EPS	FY: Dec	P/E
Current Price	\$ 0.50	1999	\$ (0.34)	-1.5
52-Week Range	3.50-28	2000E	\$ 0.04	11.8
Shares Out (Mill)	26.1	2001E	\$ 0.08	6.4
Ave Volume LTM	174,300	Valuation		LTM
Market Capitalization	\$ 13.0	P/E (Next FY)	11.8	(1.1-4.1)
LTD/Total Capital	8.2%	P/B	7.7	32-9
Institutional Holdings	21.0%	Price/Sales	1.4	9.1-1.2
Insider Holdings	3%	Operating Data		LTM
Book Value	\$ 0.06	Sales Growth	31.2%	26.5%
30Yr Bond	5.80%	EBITDA Margin	-18.1%	49.0%
Oil/Barrel	\$ 35.01	Net Inc. Growth	143%	-83.4%

Source: Baseline except for EPS estimates



Source: Big Charts

### Key Investment Points

- NEOP's detection units are the preferred way to stage and detect breast cancer and melanoma
- Proprietary technology
- Signed exclusive worldwide marketing agreement with a subsidiary of Johnson & Johnson
- Only publicly-traded pure-play in this sector.
- Our 12-18 month target price range is \$1.25.

### Company Description

Dublin, Ohio-based Neoprobe is dedicated to improving the diagnosis and treatment of cancer by the innovative use of gamma guided surgery. Neoprobe's main product is a gamma detection device used for a surgical procedure called intraoperative lymphatic mapping ("ILM") of the sentinel node. ILM is a minimally invasive technique for evaluating the potential spread of cancer to lymph nodes. Surgeons are using lymphatic mapping as a standard of care for patients with malignant melanoma and investigating its use with breast cancer. The company is developing strategic partnerships to commercialize products worldwide that are based on its proprietary radioimmuno-guided surgery technology (RIGS®).

## **INVESTMENT THESIS**

We think NEOP could post impressive operating results as the result of its patent-protected technology aimed to help treat two of the fastest growing types of cancer (breast and melanoma) and teamed with a major healthcare marketer. Top and bottom line growth is expected to accelerate as Ethicon EndoSurgery, Inc. (a subsidiary of Johnson & Johnson) executes on the exclusive worldwide marketing agreement it signed with NEOP in late 1999. Although NEOP's current product line consists of two versions of a detection unit, future R&D could lead to additional uses and new products.

## **COMPANY OVERVIEW**

Founded in 1983, Neoprobe has been focused on developing more effective ways to detect and remove cancer. Initially, NEOP developed two promising technologies, but these were effectively put on hold in 1998 until partners can be found to finance the additional testing required by US and European regulators. NEOP is currently focused on growing its ILM business and signed a distribution and marketing agreement with Ethicon EndoSurgery, Inc. (EES), a subsidiary of Johnson & Johnson. The Company is just emerging from a restructuring period that saw significant reductions in headcount and R&D spending.

### **Product Line**

NEOP developed three promising cancer detection tools:

- ILM, a detection device that helps determine the probable migratory pathways;
- RIGS® - RadiolImmunoGuided Surgery technology, a cancer detection tool; and
- ACT - Activated Cellular Therapy, an adjunctive therapeutic cancer treatment.

Of the three technologies, only ILM is currently being commercialized by NEOP. A foreign company, with an option agreement with NEOP, is pursuing RIGS technology.

### ILM – Intraoperative Lymphatic Mapping

Surgeons can use ILM to trace the potential spread patterns of cancer in the lymph system. With this procedure, a radioactive tracing agent is injected at the site of the main tumor. The tracing agent then follows the same paths through the lymphatic system as the cancer would take if it metastasized. This helps surgeons find the first lymph node (sometimes called the "sentinel" node) that might be the cancer's next point of spread and provides critical information about the stage of the patient's cancer. Once identified with a probe, the sentinel nodes can be biopsied to determine if the cancer has spread.

The effectiveness of ILM has been shown to be very effective and has been established as the standard of care for certain forms of cancer. Clinical studies involving nearly 2,000 patients have shown that *lymphatic mapping has been shown to be 97% accurate in predicting the presence or absence of disease spread in melanoma or breast cancer.* With ILM, over 80% of patients who would have undergone lymphadenectomies can be spared this radical surgical procedure. Lymphatic mapping has been declared by the World Health Organization ("WHO") to be the standard of care for treating cutaneous malignant melanoma. This technique is also becoming a standard of care for breast cancer in major cancer centers and is being confirmed through on-going trials.

In addition to lymphatic mapping, NEOP's units are also being investigated by surgeons for other gamma guided surgery applications such as:

- Evaluating the thyroid function,
- The intraoperative localization of small, painful, bone lesions (osteoid osteomas), and
- Staging (determining how to prospectively treat) patients with vulvar, prostate, gastrointestinal, and penile cancers.

NEOPs ILM product line consists of two models of the core detection unit and a series of probes that are used with these units.

Neoprobe1500™ was the Company's original product and consisted of a detection unit and the 14mm probe, which had to be re-sterilized after each use. It is not self-calibrating nor is its software upgradeable. However, NEOP's new probes (discussed below) can be used with this model.

The neo2000® unit is a radically redesigned version that has the following enhanced features:

- Automated windowing
- Automatic calibration,
- Sound modes to help in detection, and
- Ability to upgrade software to latest technology

The Company also produces a line of probes. The original probe is called the 14mm probe and is a stainless steel wand that is reusable, but re-sterilization creates a time and cost factor that led to the development of NEOP's other line of probes.

NEOP's second-generation of probes is called BlueTip™. These probes have the following key new features:

- Interchangeable tips with varying fields of view to better localize the area,
- Can be interchanged in a sterile field,
- The handle is ergonomically designed, low cost, and single-use,
- Eliminates the need for bulky drapes, and
- These tips can be used with either unit

NEOP has outsourced the manufacturing and marketing of its products. We think this is a good strategy because it allows NEOP to focus on what it does best (R&D) while benefiting from the expertise and operating efficiencies developed by its partners.

Manufacturing has been outsourced to several firms: Plexus Corporation (PLXS-\$62.00), The MedTech Group, Inc., and eV Products, a subsidiary of II-VI Corporation (IIVI-\$15.75).

Marketing is outsourced to Ethicon Endo-Surgery, Inc. ("EES") under an agreement signed in October 1999. This worldwide marketing agreement calls for:

- An initial term of five years, with options to extend for two successive two-year terms,
- EES becomes the exclusive worldwide distributor of NEOP's units
- EES will purchase a minimum quantity of units during the first three years,

- EES to reimburse NEOP for certain R&D expenses and a portion of warranty costs,
- EES will receive a non-exclusive, worldwide paid-up license to the ILM intellectual property,
- NEOP received an initial payment from EES of \$4 million (which is being recognized evenly over the initial five-year term),

### RIGS

From inception to 1998, NEOP developed RIGS technology. This system combines a patented hand-held probe, proprietary cancer targeting agents, and patented surgical techniques that help surgeons locate and more thoroughly remove cancers that are not detectable by conventional methods.

In Phase 3 clinical trials, RIGS detected cancer that would have otherwise been missed in 20% of the cases. From 1992 throughout 1996, NEOP conducted clinical trials on over 700 patients. In 1996, NEOP submitted applications to the FDA and its European counterpart for marketing approval. Both agencies acknowledged that NEOP's studies met the diagnostic requirements of the Phase III study, but they wanted additional information to know how the finding of additional tumors provided clinical benefits to the patient.

During 1998, as NEOP discussed this request for additional information, the Company decided that the best way to obtain regulatory approval would be to re-apply using its second generation of RIGS technology. However, NEOP determined it could not go forward without a partner who could shoulder both the costs and risks associated with another set of clinical trials.

At this writing, while NEOP is in negotiation with NuRigs, Ltd. (discussed below), it has not reached a definitive agreement with any party that would ensure the continued development of the RIGS process. If an agreement is eventually reached with another party, NEOP believes that it will take a minimum of four to five years before it receives any significant product-related royalties.

### NuRIGS

NuRigs, Ltd. (NuRIGS), based in Tel Aviv, Israel was formed by an independent group of Israeli and European physicians and investors for the express purpose of developing a second-generation RIGScan CR antibody fragment (a cancer marker). During 1Q00, NEOP entered into an option agreement for the development of the new RIGScan CR product. The option agreement calls for NEOP to receive:

- \$50,000 in option fees (recognized in 1Q00), and
- Licensing fees of \$900,000 and a 5% royalty upon the execution of a definitive agreement.

Under the proposed agreement, NuRIGS will assume all the clinical and other development costs for RIGScan CR. A definitive agreement is not expected to be finalized until late 4Q00, at the earliest, but there are no assurances that an agreement will be reached.

## ACT

Activated Cellular Therapy was an offshoot of RIGS technology that boosts the patient's own immune system by:

- Removing lymph nodes identified via RIGS testing,
- Cultivating "helper" T-cells found in the removed lymph nodes, and
- Infusing the "helper" T-cells back into the patient where they help enhance a variety of chemotherapeutic agents.

Phase I testing provided encouraging results in colorectal cancer and HIV patients, but the Company decided to not proceed with regulatory approval until it can find a partner who will assume the financial burden of clinical development and seeking regulatory approval.

## **INDUSTRY OVERVIEW**

Cancer is the primary focus of NEOP's products and is the second leading cause of death in the US (over half a million deaths annually) and Western Europe. The National Institutes of Health ("NIH") estimate that cancer costs \$107 billion annually, comprised of:

- \$37 billion in direct medical costs,
- \$11 billion for morbidity, and
- \$59 billion for mortality.

NEOP's ILM products are currently used for the treatment of two forms of cancer; breast and melanoma and the procedure has become the standard of care at many institutions. In fact, the World Health Organization declared that lymphatic mapping was the standard of care for coetaneous malignant.

### Breast Cancer

NIH estimates that breast cancer will hit 500,000 women annually, with 80% of them undergoing a lymph node dissection to determine if the disease has spread. There are currently over 12,000 hospitals in NEOP's target markets that could use their product in the detection process.

### Melanoma

Melanoma is the fastest growing type of cancer in the US and Europe. Approximately 32,000 annually are diagnosed in the US. This type of cancer is currently growing at a 4.3% annual rate. ILM staging has been widely accepted for treatment of melanoma.

### Core Market Potential

In this section, we estimated the market potential in NEOP's current market niche, focusing only on the potential market for breast cancer and melanoma treatments during the next two years. We take this narrow view because, while NEOP's products could be used for other treatments, the devices are only approved for use in these two types of cancer. We limit ourselves for only two years because we do not have sufficient data to determine how rapidly the market will adopt NEOP's technology. It should be noted that market share information is not available because of the highly competitive market and because the other players are either privately held or subsidiaries of larger corporations.

We estimate the core market potential demand during the next two years to be \$85 million and represents our estimated potential demand for NEOP's products with applications limited to

breast cancer and melanomas and based on wholesale pricing. Of this amount we think NEOP could capture 30% or \$25 million over the two-year period. However, our earnings forecast assumes that NEOP has sales of \$21 million for 2000 and 2001.

We arrived at our core market demand estimate by assuming:

1. \$43 million market (wholesale pricing) for units, consisting of:

- A current market potential of 18,000 units (the current target market of 12,000 teaching and cancer center hospitals will need an average of 1.5 units each),
- Over the next two - three years, we estimate that approximately 30% of these hospitals will purchase probes, and
- NEOP will sell each unit at an estimated average wholesale price of \$8,000 (units are sold to EES at this estimated rate).

We assumed 1.5 units per site for the next two years based upon the expected need for a hospital to have more than one unit. Initially, one unit may suffice, but the need for a second or third unit is expected to increase due to the growth in the number of breast cancer and melanoma patients needing treatment.

While the retail market represents a much larger dollar figure, we focused on the wholesale level because this is where NEOP is transacting business. While the competition is selling direct, NEOP is selling to its exclusive distributor at a lower price point. We arrived at our wholesale price estimate by examining operating margins of other medial supply firms and making assumptions about overhead and required returns to the marketer.

2. \$42 million handle market (\$21 million per year):

NEOP's BlueTip™ probes could provide additional revenues from its disposable handle. The disposable handle would reduce the time needed to prep the unit for the next patient and provides the surgeon with flexibility and more precise detection.

We think this represents an additional \$21million annual market based on the following assumptions:

- Half of the estimated 400,000 lymph node dissections related to breast cancer use disposable handles;
- Half (15,000) of the annual melanoma cases use disposable handles; and
- At a wholesale price of \$100 per handle.

The market potential could increase if there is:

- An increased acceptance of the product for treatment of other types of cancer
- A significant increase in the occurrence of melanomas and breast cancers

NEOP's competition comes from two other firms: US Surgical (a subsidiary of Tyco) and to a lesser extent Carewise Medical, Inc. Market share data is not available due to the intense competition. While the major competitor (US Surgical) has the potential to spend more on

marketing, we think NEOP has the advantage in R&D because it is more focused on this niche and can react faster to new developments.

## **COMPETITIVE ADVANTAGES**

We think NEOP's competitive advantages lie in the Company's focus on creating a user-friendly machine that can be easily upgraded. The key areas where NEOP's system gives it a competitive advantage are:

- **Upgradability:** neo2000 units can be reprogrammed easily and quickly with software upgrades;
- **Client Focused:** Client suggestions can be easily incorporated into software and released to the client base;
- **Adaptable to multiple isotopes:** could provide additional uses for the system;
- **Larger line of probes;** provides increased targetability;
- **Audio ranging:** allows Doctors to keep eyes on the patient rather than focusing on a screen while moving a probe; and
- **NEOP can react faster to the market because it is an independent company instead of a small unit of a huge firm.**

## Patents

NEOP's ILM technology is currently protected by 12 patents and 20 patent applications that have been filed in the US and Europe. While not currently integral to NEOP's operations, the Company is maintaining patents on RIGS and ACT technologies.

## **MANAGEMENT**

*David C. Bupp, President and CEO.*

Brings financial and business skills that are used to determine economic feasibility of the company's R&D efforts.

- President since 1992 and CEO since 1998.
- Joined NEOP in 1990 as Vice President and CFO. Also served as Treasurer, Acting President, Executive Vice President, and Chief Operating Officer.
- Prior to NEOP, Mr. Bupp was Senior Vice President, Regional Manager for Ameritrust Company, NA where he was responsible for commercial banking operations throughout Central Ohio.
- He has a B.A. degree in economics from Ohio Wesleyan University and has completed a course of study at Stonier School of Banking.

*Carl M. Bosch, Vice President Instrument Development.*

Directs the R&D effort and has an extensive background in medical systems and electrical engineering.

- Appointed to his current position in March 2000.
- Joined NEOP in 1998 as Director of Instrument Development.
- Prior to joining NEOP, he was Manager, Nuclear Programs at GE Medical Systems (1994-1998).
- He was also employed by GE Aerospace in several engineering and management positions.
- Mr. Bosch has a B.S. degree in Electrical Engineering from the University of Pennsylvania and a M.S. degree in Systems Engineering from Lehigh University.

*Brent L. Larson, Vice President, Finance and CFO.*

Established financial controls, manages internal/external reporting, oversees budgeting and works with CEO to determine economic feasibility of R&D efforts.

- Appointed to his current position in 1999.
- Join NEOP in 1996 and served as Vice President Finance and Comptroller for NEOP.
- Before joining NEOP, he was employed by Price Waterhouse LLP for 12 years.
- Mr. Larson has a B.B.A. degree in accounting from Iowa State University of Science and Technology and is a CPA.

## **OPERATING RESULTS**

### Historical Review

NEOP was a development-stage company, fully focused on research and development of its various technologies until 1997. Starting in 1997, the Company entered into a series of marketing contract that boosted revenues from previous levels (see Figure 1).

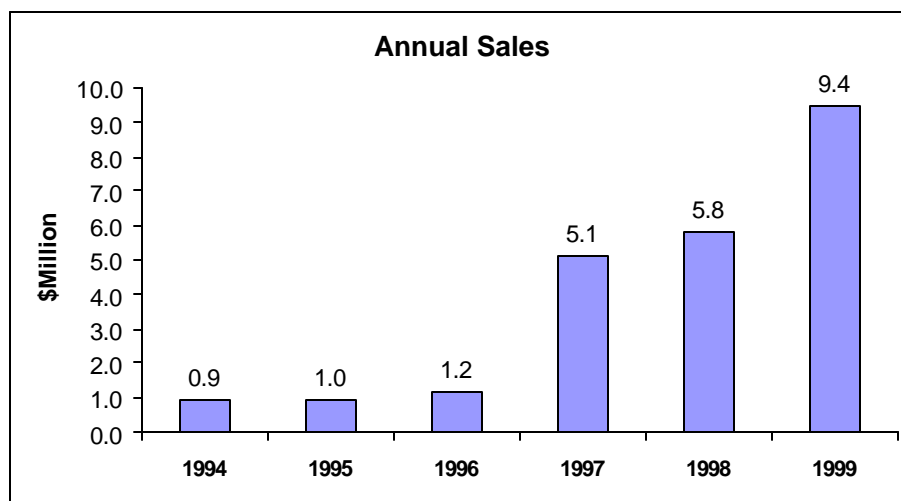


Figure 1

Sales in 1997 and 1998 were relatively flat as NEOP was forced to renegotiate marketing relationships due to changing market conditions (see Table 1). In 1999, sales were boosted by sales of demo units in 4Q99 when NEOP finalized the marketing agreement with EES. The intermittent relationship between NEOP and EES resulted from changes in the market and subsequent recognition of the benefits of working together. The fact that EES came back and made a significant commitment to NEOP is, in our opinion, an indication of the competitive advantages of NEOP's technology.

Start Date	Company	Terminated
September 1996	US Surgical	October 1997
April 1998	EES	March 1999
February 1999	KOL Biomedical	October 1999
October 1999	EES	

Despite improved sales trends, operating results deteriorated during the 1997-1998 period due to:

1. Operating expenses associated with re-establishing an in-house marketing effort due to the termination of the 1998 marketing agreement with EES, and
2. \$7 million in charge-off in 1998 for discontinued RIGS and ACT operations.

While operating expense trended down after 1997, net income suffered due to the write-offs in 1998. Figure 2 illustrates the annual investment trends in the three major operating expense categories and Figure 3 shows the impact on net income. Note that excluding the \$7 million charge off in 1998, the net operating loss would have been \$20 million, a \$3 million improvement over 1997.

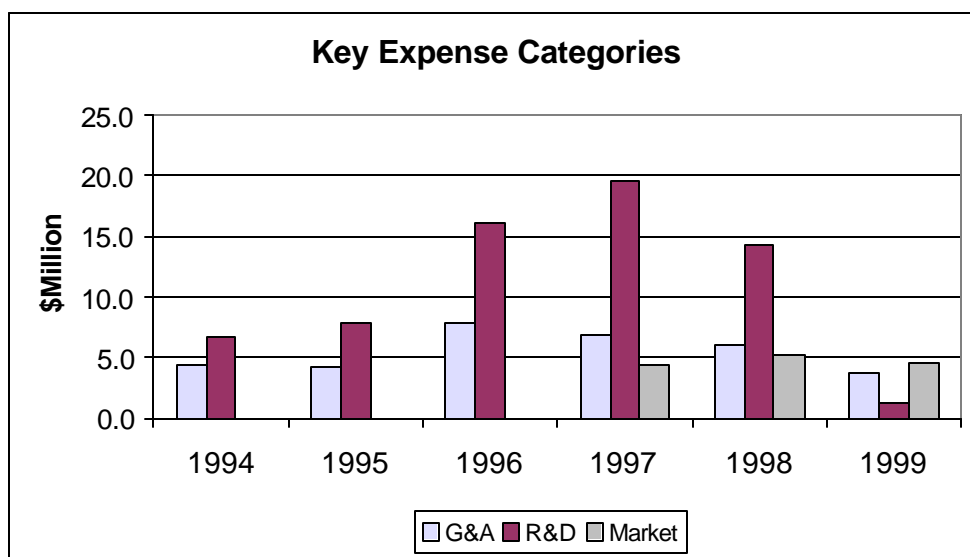


Figure 2

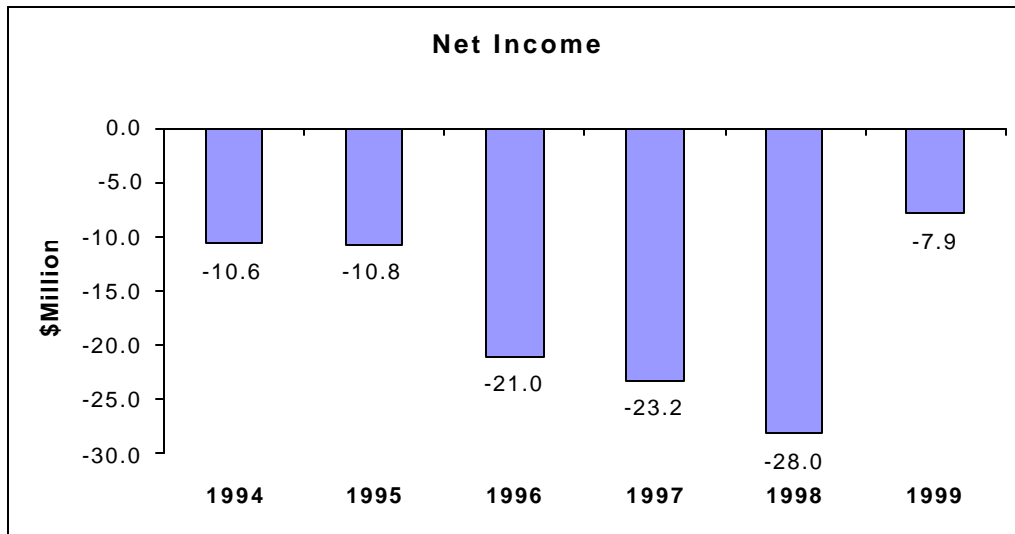


Figure 3

Fiscal Year 1999

1999 operating results improved as the result of the hard choices management made during 1997-1998. With RIGS and ACT operations suspended, management was now free to focus on ILM and restructure operations for long-term profitability by significantly reducing headcount and successful efforts to outsource marketing. As shown in Figure 4, operating performance, while still negative, has done an impressive turn-about throughout 1999 and in 2000.

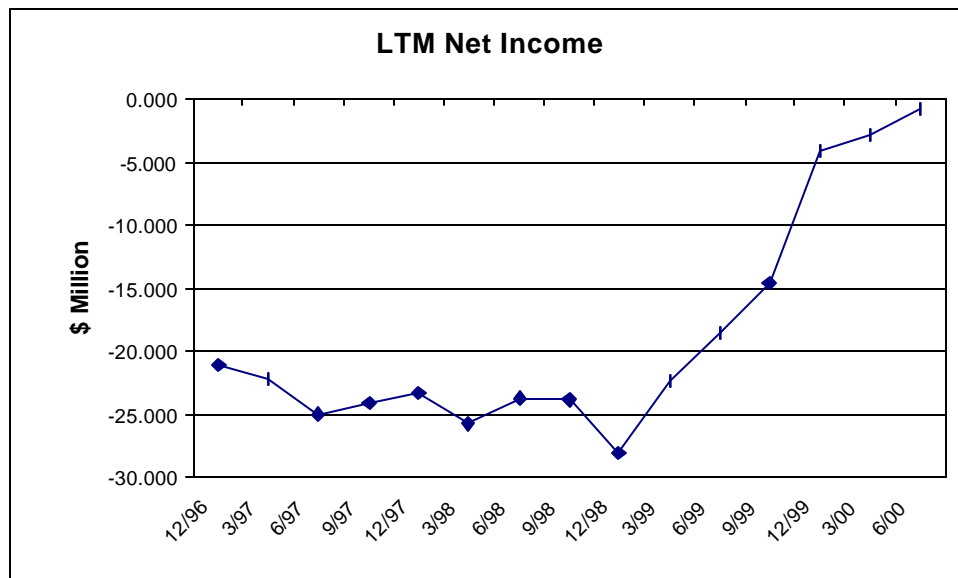


Figure 4

On a cash flow basis, the improvement in operating performance is even more pronounced. As shown in Figures 5 and 6, **cash flow from operations was consistently better than accounting income, and turned positive in 1999.**

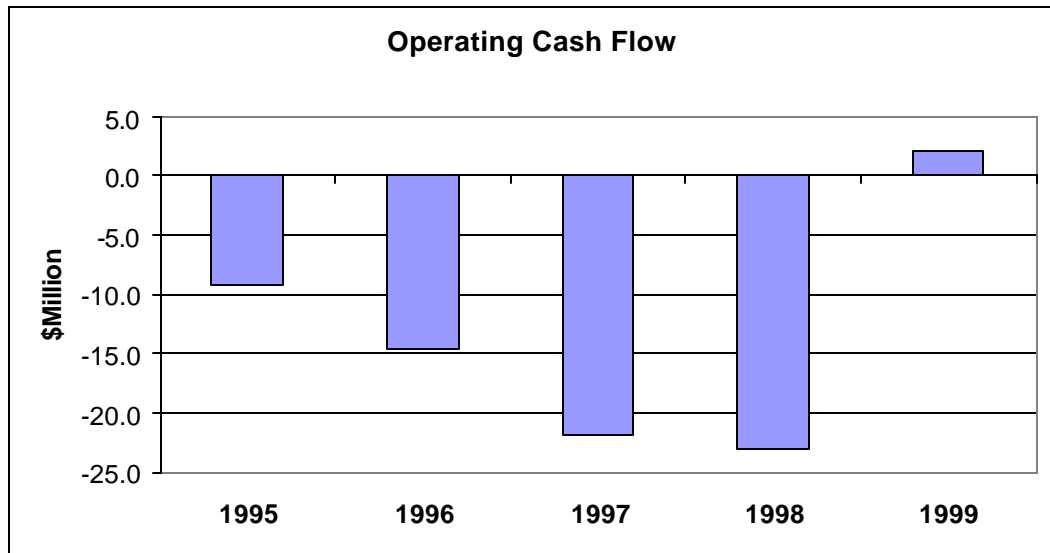


Figure 5

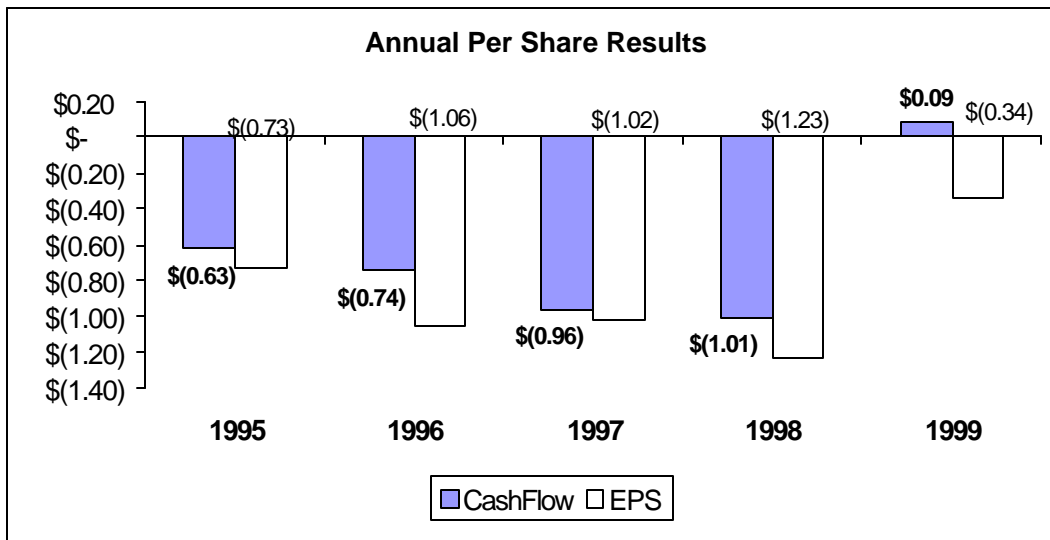


Figure 6 (Note: Boldfaced data refers to cashflow per share.)

Recent Results: 2Q and First Half 2000

Operating results continued to improve in 2000 and benefited from outsourcing the marketing function. As shown in Table 2, top line growth accelerated as the result of increased unit sales and licensing fees. Operating margins swung into positive territory due to the net effect of the marketing agreement with EES and reduced overhead costs.

	<b>2Q99</b>	<b>2Q00</b>	<b>Change</b>	<b>1H99</b>	<b>1H00</b>	<b>Change</b>
Sales: Product	\$ 1.92	\$ 2.51	31.2%	\$ 3.83	\$ 4.12	7.6%
License	0.00	0.20	na	0.00	0.45	na
<b>Total</b>	<b>1.92</b>	<b>2.71</b>	<b>41.6%</b>	<b>3.83</b>	<b>4.57</b>	<b>19.4%</b>
Gross Margin	65.7%	46.8%	-28.8%	66.6%	50.0%	-24.9%
Marketing	1.14	0.05	-95.4%	2.26	0.16	-92.8%
G&A	0.81	0.57	-29.8%	1.82	1.24	-31.9%
R&D	0.35	0.08	-77.0%	0.81	0.38	-53.9%
<b>Operating Inc.</b>	<b>-1.43</b>	<b>0.57</b>	<b>139.6%</b>	<b>-281.4%</b>	<b>51.1%</b>	<b>118.2%</b>
Net Interest	-0.01	0.04	-840.0%	0.01	0.07	1340.0%
Pre-tax	-1.43	0.64	144.7%	-273.8%	61.3%	122.4%
Net Income	-1.47	0.63	142.6%	-273.8%	60.0%	121.9%
<b>EPS</b>	<b>\$ (0.06)</b>	<b>\$ 0.02</b>	<b>136.6%</b>	<b>\$ (0.20)</b>	<b>\$ (0.01)</b>	<b>96.2%</b>

Source: Company data

Licensing fees consists of a one-time payment of \$50,000 recognized in 1Q00 from NuRigs, Ltd. and the amortization (\$200,000 per quarter) of the funds received from EES (both discussed above).

The decline in the gross margin is a function of the EES deal and is offset by reductions in marketing expenses. Under the agreement, NEOP sells units to EES at wholesale but is relieved of the need to fund marketing costs. The net effect is that the ratio of cost of goods sold plus marketing expense relative to sales improved from 93% in 2Q99 to 57% in 2Q00.

For 2Q00, NEOP was not liable for a material amount of income tax due to significant operating loss carryforwards. At December 1999, total tax credits amounted to \$98.2 million and is available to offset any income through 2019. However, full use of this credit may be limited due to management changes that have occurred in the past. Also, starting later in 2000, NEOP will be subject to Alternative Minimum and local taxes that cannot be fully offset by the NOL credits. We estimate that the net tax effect will be approximately 4% of pre-tax income.

## **FINANCIAL CONDITION**

NEOP's financial condition is normal for a firm emerging from the development stage. Over the years, financial leverage (defined as debt/capital) fluctuated between the mid-teens to the mid-20's as NEOP's financed operating losses with combinations of debt and capital infusions. Leverage temporarily spiked at year-end 1999 due to timing issues involved in the accounting treatment for Company's restructuring of preferred stock that was issued earlier in 1999.

To gain a better perspective for NEOP's financial condition, Table 3 compares NEOP's 2Q00 results with a peer group comprised of small-cap medical diagnostic firms. (We excluded IGEN Int'l. from the peer averages because they would skew the data.) We included details on debt, equity, operating cash flow and retained earnings in order to provide additional reference points.

(\$Million		<b>Debt/</b>	<b>LTM</b>	<b>Debt</b>	<b>Equity</b>	<b>Ret'd</b>
<b>Company</b>	<b>Symbol</b>	<b>Equity</b>	<b>EBITDA</b>			<b>Earns</b>
TRIPATH IMAGING	TPTH	16%	-0.53	7.10	43.10	-175.2
CELSION	CLN	2%	-9.67	0.10	5.20	-24.9
FISCHER IMAGING	FIMG	22%	0.05	5.00	22.30	-21.0
VISTA MEDICAL TECH	VMTI	0%	-0.79	0.00	7.50	-59.9
MATRITECH	NMPS	7%	-9.00	0.50	6.70	-50.3
CHROMAVISION MED SY	CVSN	0%	-14.88	0.00	14.20	-41.7
VYSIS	VYSI	1%	-0.19	0.10	11.90	-60.8
PHOTOELECTRON	PHX	-700%	-4.23	10.50	-1.50	-42.2
IGEN INT'L	IGEN	-328%	-1.13	57.10	-17.40	-119.4
Average*		7%	-4.48	8.93	10.22	-66.2
<b>NEOPROBE CORP.</b>	<b>NEOP</b>	<b>15%</b>	<b>4.68</b>	<b>0.26</b>	<b>1.73</b>	<b>-119.0</b>
JOHNSON & JOHNSON	JNJ	18%		3304.00	17979.00	

\* Average Debt/Equity excludes PHX & IGEN  
Source: Baseline and Company data.

The key points of this comparison are that NEOP's:

- Leverage is not excessive (within the group's range);
- Operating cash flow (EBITDA) is significantly better;
- Equity base is relatively thin, but accumulated losses are not out of line with the peer group.

## OUTLOOK

We think NEOP can post EPS of \$0.04 in 2000 and \$0.08 in 2001 based upon the following assumptions:

- We kept our quarterly unit sales forecast relatively flat with 2Q00 results because we think this is a good approximation of volume at this early stage of the marketing arrangement with EES. While we expect some pricing pressure in 2001, we think this could be offset by increased volume;
- The gross margin on units sold is constant at 45% (which approximates the average margin during 1H00);
- NEOP's residual marketing costs increase 3% annually;
- G&A grows at a 3.5% rate quarter over quarter; and
- Taxes are estimated at 4% of operating income and approximate the impact of the Alternative Minimum Tax and local taxes that are not offset by NOL tax credits.

Our annual EPS model is summarized in Table 4, below. Note that revenue growth slows in 2000 due to the difficult comparison with 4Q99 when a large number of demo units were sold to EES.

<b>Table 4: Annual Income Statement &amp; Forecast</b>						
(\$Million, except per share data)						
	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>
Unit Sales	1.17	5.13	5.83	9.25	<b>9.12</b>	<b>10.40</b>
Lic Fees	0.00	0.00	0.00	0.20	<b>0.85</b>	<b>0.80</b>
Total Revenues	1.17	5.13	5.83	9.45	<b>9.97</b>	<b>11.20</b>
Cost of Goods Sold	0.68	1.58	1.40	4.51	<b>5.03</b>	<b>6.05</b>
Gross Margin	0.49	3.55	4.43	4.94	<b>4.94</b>	<b>5.15</b>
SG&A	7.75	11.16	11.36	8.21	<b>2.70</b>	<b>2.81</b>
R&D	16.08	19.66	14.37	1.31	<b>0.54</b>	<b>0.50</b>
Operating Income	-23.34	-27.27	-28.47	-5.06	<b>1.70</b>	<b>1.85</b>
Interest Expense	0.00	0.00	0.60	0.10	<b>0.17</b>	<b>0.18</b>
Other Income/Exp.	2.37	4.02	0.03	0.16	<b>0.09</b>	<b>0.15</b>
PreTax Income	-20.97	-23.25	-28.03	-4.17	<b>1.94</b>	<b>2.15</b>
Income Taxes	0.00	0.00	0.00	0.00	<b>0.05</b>	<b>0.09</b>
Net Income	-20.97	-23.25	-28.03	-4.17	<b>1.88</b>	<b>2.06</b>
Stock Convresion	0.00	0.00	0.00	-3.72	<b>-0.76</b>	<b>0.00</b>
Net to Comm SH	-20.97	-23.25	-28.03	-7.90	<b>1.12</b>	<b>2.06</b>
<b>EPS-Diluted</b>	<b>N/A</b>	<b>\$ (1.02)</b>	<b>\$ (1.23)</b>	<b>\$ (0.34)</b>	<b>\$ 0.04</b>	<b>\$ 0.08</b>
Ave. Shares Out.		22.7	22.8	23.0	<b>26.7</b>	<b>26.7</b>
Effect. Tax Rate		0.0%	0.0%	0.0%	<b>2.7%</b>	<b>4.0%</b>
<b>Growth Rates</b>						
Revenues	22.0%	337.9%	13.7%	58.5%	<b>-1.4%</b>	<b>14.1%</b>
Operating Income	102.6%	16.8%	4.4%	-82.2%	<b>-133.6%</b>	<b>8.6%</b>
Net Income	94.9%	10.9%	20.6%	-71.8%	<b>-114.2%</b>	<b>84.3%</b>
EPS		N/A	20.0%	-72.0%	<b>-112.2%</b>	<b>83.9%</b>
<b>Margin Analysis</b>						
Gross (ex-Lic. Fees)	42.2%	69.3%	75.9%	51.2%	44.8%	41.8%
Operating	-1993.4%	-531.7%	-488.1%	-54.7%	<b>18.6%</b>	<b>17.7%</b>
Net	-1790.8%	-453.3%	-480.6%	-45.1%	<b>20.6%</b>	<b>19.8%</b>
<b>Boldfaced data are estimates</b>						

Note: The decline in the gross margin from 1999 to 2001 reflects the impact of the wholesale pricing arrangement with EES and is offset by a reduction in marketing expenses.

## VALUATION ANALYSIS

Our 12-18 month target price is \$1.25 and is based upon our 2001 forecast and what we think are conservative multiples. We will first present our valuation model and then discuss valuations relative to NEOP's historic levels as well as the current level of the peer group.

Table 5 illustrates how we calculated our target price, by triangulating off three variables; price/sales, price/book, and EPS. High/Low ranges for each variable were derived from examining historic ranges, current valuations for 250 medical supply companies, and discounting for liquidity and relative size concerns. The target price is the average of the High/Low range.

Price to:	LTM Range		Assumed Multiple	2001 estimate	Range
	Absolute	Average			
<b>Sales</b>	9.3	4.8	5.0	\$ 0.42	\$ 2.09
	1.2	1.6	1.5		\$ 0.63
<b>Book</b>	32.4	-154.5	15.0	\$ 0.14	\$ 2.13
	-93.7	-22.0	5.0		\$ 0.71
<b>EPS</b>	-1.1	-6.0	20.0	\$ 0.08	\$ 1.54
	-4.1	-2.2	5.0		\$ 0.39
Average High				\$	1.92
Low				\$	0.58
Average				\$	1.25

For comparative purposes, Table 6 contains valuation multiple (where available) on NEOP's peer group.

Company	Symbol	Price	Market Cap.(MM)	LTM Return	P/B	P/S	Calendar P/E		
							1999	2000	2001
TRIPATH IMAGING	TPTH	\$ 8.69	248.4	88%	6.0	9.3	-7.6	-23.5	72.4
CELSION	CLN	\$ 1.94	117.6	113%	102.0	-	na	na	na
FISCHER IMAGING	FIMG	\$ 3.47	28.0	247%	1.1	0.5	-5.4	na	na
VISTA MEDICAL TECH	VMTI	\$ 1.00	19.5	46%	4.9	2.9	-1.5	na	na
PHOTOELECTRON	PHX	\$ 3.75	29.4	-13%	-	24.2	-3.9	na	na
MATRITECH	NMPS	\$ 5.81	145.6	121%	26.8	153.8	-20.0	na	na
CHROMAVISION MED	CVSN	\$ 8.75	170.8	-40%	11.9	229.4	-13.9	-12.3	-54.7
VYSIS	VYSI	\$ 5.81	58.7	84%	5.0	2.7	-5.3	-18.2	290.6
IGEN INT'L	IGEN	\$21.00	331.9	-22%	-	13.7	-14.6	-12.8	-17.1
average			127.8	69%	22.5	54.6	-9.0	-16.7	72.8
<b>NEOPROBE CORP.</b>	<b>NEOP</b>	<b>\$ 0.50</b>	<b>13.0</b>	<b>0%</b>	<b>7.7</b>	<b>1.4</b>	<b>-1.5</b>	<b>11.9</b>	<b>6.5</b>
	JNJ	\$95.81	133211.2	3%	7.4	4.7	29.8	32.4	28.3

Source: Baseline, Company data, and researchstock.com.

We think our target price multiples are conservative multiples because they are based on historic averages, a time when the Company was undergoing significant changes and incurring large losses. With these challenges resolved and operations turning profitable, we expect these multiples to expand over the coming quarters if NEOP can continue to post improved operating results.

## **Risk Considerations**

Investors need to consider the following risks before investing:

The Company currently sells just one product (the ILM technology) with a growing number of attachments and supplies. A second-generation model is being developed, but the timing of a rollout is difficult to forecast because FDA testing is required.

While other uses are under development, the units are only widely used in the diagnosis and treatment of two primary types of cancer: melanoma and breast cancer. While the Company believes that its technology has significant advantages over other methods, broad-based acceptance will not occur until physicians outside major cancer centers and teaching hospitals adopt the ILM approach.

NEOP is highly dependent on EES, the company's exclusive distributor. EES is a subsidiary of Johnson & Johnson. EES has agreed to purchase a minimum quantity of NEOP products during the first three years (until late 2002) of the first five-year term of the agreement. However, there can be no assurances that EES will purchase product from NEOP in excess of the minimum or that such purchases will generate sufficient cash flow to finance NEOP's operations over the long term.

The Company has outsourced its manufacturing needs and is dependent on one supplier. While we think it was a good decision to outsource manufacturing, this does result in the risk that the supplier may devote resources to other clients and not meet the needs of NEOP.

The shares are not very liquid. Average daily volume for the last 30 days has been about 16,000 shares. While this is significantly greater than the average of 8,000 during the last 12 months, the shares remain thinly traded and could experience significant price volatility.

The Company is not widely followed by Wall Street analysts (we are initiating coverage with this report). Consequently, it is possible that valuations differential could persist due to a lack of analyst support.

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