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# Neoprobe Corporation

OTC: BB-NEOP- \$0.38

www.neoprobe.com

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## 4Q and FY01 Results

### Recent Acquisition Holds Great Promise, But Development Costs Will Reduce EPS through 2003

Current Data		EPS	FY: Dec	P/E
Current Price	\$ 0.38	2001	\$ 0.00	659.9
52-Week Range	\$1.05-0.34	2002e	\$ (0.11)	-3.5
Shares Out (Mill)	36.5	2003e	\$ 0.00	1043.9
Ave Volume LTM	71,500	Valuation		LTM
Market Capitalization	\$ 13.9	P/E (Next FY)	-3.5	16.7-5.4
LTD/Total Capital (est.)	0.5%	P/B	1.4	9-2.4
Institutional Holdings	18.1%	Price/Sales	2.0	3.2-1.1
Insider Holdings	12%	Operating Data		LTM
Book Value (est.)	\$ 0.26	Sales Growth	-34.6%	-23.5%
10Yr Bond	5.20%	EBITDA Margin	17.7%	14.2%
Oil/Barrel	\$ 24.93	Net Inc. Growth	-189%	98.5%

Source: Baseline, Big Charts, and researchstock.com



Source: Big Charts

### Key Investment Points

- Core results for 4Q01 and FY 2001 were slightly better than we expected.
- Reported results were adversely impacted by a one-time charge of \$885,000.
- Cardiosonix acquisition has long-term future potential.
- New equity line will provide needed funds and improve capital structure, but if tapped will also result in dilution.
- Our 12-18 month target price is \$0.50.

### Company Description

Dublin, Ohio-based Neoprobe is a biomedical technology company that provides innovative surgical and diagnostic products. Currently, 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 currently in the process of commercializing a unique line of blood flow measuring devices under the Cardiosonix brand name. The blood flow measurement devices market is estimated to be \$1.5 billion.

## The Bottom Line

The Cardiosonix acquisition improved NEOP's long term potential by providing product diversification, access to a larger market (blood flow measuring devices in cardiac care and neurosurgery) and leverages NEOP's regulatory, production and marketing experience. The cost of commercializing Cardiosonix's products will cause NEOP to post a net loss in 2002. But NEOP could post positive earnings and cash flow in the second half of 2003 if it can successfully start marketing a blood flow measuring device by 4Q02.

## 4Q01 Results

4Q01 results for core operations were better than we expected. Core EPS (excluding a \$60,000 sales "catch-up" and the in process R&D charge off) was \$0.01 versus our forecast of \$0.00, but was below the \$0.03 recorded in 4Q00. Core sales for the quarter were \$1.64 million, down 58% from 4Q00 due the reduction in the contract pricing with Ethicon Endo-Surgery, Inc. ("EES") and lower unit volumes. The one-time reduction in the transfer pricing agreement with EES reduced sales during all of 2001. We believe that unit volumes have declined as the market of "early adopters" has been saturated and other hospitals await the outcomes of current research before making their initial purchases. The reduction in sales price and lower unit volumes caused the operating margin to decline to 10.18% from 13.2%, despite a 30% decline in G&A expense and a 100% drop in marketing expenditures. Also impacting 4Q01 margins was an \$111,000 charge for inventory obsolescence.

Reported sales for the quarter were \$1.70 million, down 35% from 4Q00. Figure 1 illustrates the impact of the reduced transfer pricing and reduced unit volumes on quarterly sales. The spike in 4Q99 was due to the initial shipment of units to EES.

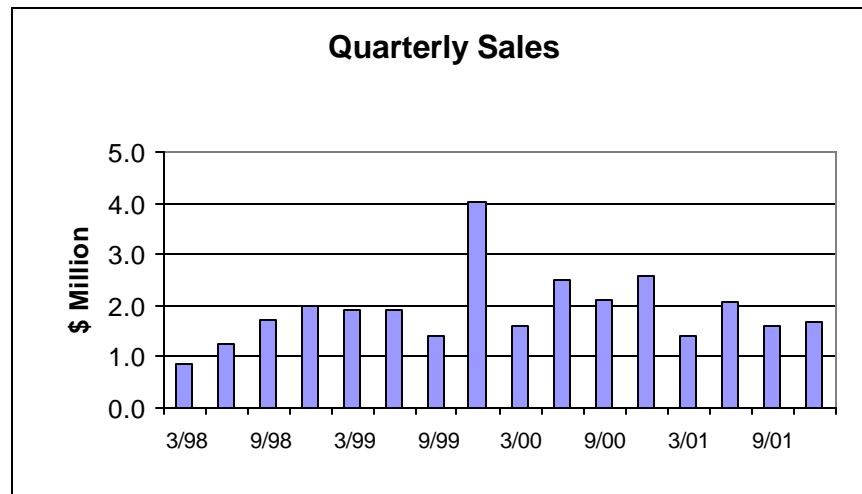


Figure 1

The combination of lower sales and the in process R&D charge off resulted in negative margins and a net loss of \$0.02 per share. Table 1 compares both reported and "core" results to 4Q00.

<b>Table 1: 4Q01 Result Comparisons</b>			
	<b>12/00</b>	<b>12/01</b>	<b>12/01</b>
(\$Mill. Except EPS)	Reported	Reported	Core
Sales (MM)-ILM	2.592	1.695	1.636
Lic Revs	0.225	0.200	0.200
<b>Total Revs</b>	<b>2.817</b>	<b>1.895</b>	<b>1.836</b>
<b>COGS</b>	<b>1.477</b>	<b>0.906</b>	<b>0.907</b>
Gross Income	1.340	0.989	0.929
Market/Sell	0.079		
G&A	0.881	0.619	0.620
R&D	0.038	0.143	0.143
Acq'd IP R&D		0.885	
Operating Income	0.342	-0.658	0.166
Interest Inc	0.075	0.016	0.016
Interest Expense	-0.003	-0.002	-0.002
Other Expenses/(Inc.)	0.283	0.004	0.004
PreTax Income	0.697	-0.640	0.184
Inc Taxes	-0.026	0.003	0.003
Net Inc	0.723	-0.643	0.181
<b>EPS-Dil</b>	<b>\$ 0.03</b>	<b>\$ (0.02)</b>	<b>\$ 0.01</b>
Dil Shares OS	25.964	26.117	26.117
<b>Margins (excl. Lic.)</b>			
Gross	51.7%	58.3%	56.8%
Operating	13.2%	-38.8%	10.1%
Net	27.9%	-37.9%	11.1%
<b>Growth</b>			
Sales		-34.6%	-36.9%
Op. Inc.		-292.4%	-51.5%
Net Inc.		-188.9%	-75.0%
EPS		-188.4%	-75.1%
<b>% Sales</b>			
G&A	31.3%	32.7%	33.8%

The in process R&D charge represents the portion of the Cardiosonix (formerly known as Biosonix) purchase price that was allocated to InFlow (TM), a product that is considered under development because regulatory approval to market the product has not yet been received. NEOP took the charge in 4Q01 because that was the quarter when the Cardiosonix acquisition was completed. NEOP hired an outside consultant in order to obtain the best determination of the goodwill associated with the Cardiosonix acquisition and determine the in process R&D that should be expensed.

## Fiscal 2001 Results

Excluding the R&D charge, NEOP would have booked EPS of \$0.03 versus \$0.04, not bad for a year when gamma probe sales declined 23.5%. License revenues declined 6% as NEOP received \$25,000 in RIGS royalties versus \$75,000 in 2000.

NEOP's sales trend masks underlying strength in the product line. In 2001, the number of units placed with users increased 30% over 2000. But because most of these placements came from EES's inventory, the growth was not reflected in NEOP's top line. Under the terms of the marketing agreement, EES is required to buy a fixed number of units regardless of their sales volume. EES has "excess" inventory because unit volumes were lower than contemplated in the contract. We do not consider this channel stuffing because it is the result of a long-term contractual obligation and EES cannot return units except for mechanical difficulties.

Operating margins declined to 7.9% from 14.6% largely due to shrinkage in the gross margin. The gross margin fell to 47.3% from 52.4% due to lower transfer pricing, lower volumes and the inventory obsolescence charge. Offsetting some of the gross margin shrinkage was a 59% decline in operating expenses that resulted from ongoing expense controls. Excluding the in process R&D charge, operating margins for 2001 would have been 7.0% versus 13.3% in 2000 and NEOP would have posted a slight profit for the year. Table 2 compares 2000 results with 2001pf that excludes the in process R&D charge.

<b>Table 2: Comparative Annual Operating Results</b>			
(\$Million)	<b>2000</b>	<b>2001pf</b>	<b>Growth</b>
Unit Sales	8.84	6.76	-24%
Lic Revs	0.88	0.83	-6%
Total Revs	9.71	7.58	-22%
<b>COGS</b>	4.99	4.39	-12%
Gross Profit	4.72	3.20	-32%
Market/Sell	0.28	0.00	-100%
G&A	2.68	2.32	-13%
R&D	0.47	0.34	-27%
In Process R&D			na
Operating Income	1.29	0.53	-59%
Interest Inc	0.21	0.13	-38%
Interest Expense	-0.03	-0.01	-56%
Other Income/Expenses	0.37	0.25	-32%
PreTax Income	1.84	0.02	-99%
Inc Taxes	0.00	0.00	na
Net Inc	1.84	0.02	-99%
EPS-Dil	\$ 0.04	\$ 0.00	-98%
Diluted Shares	26.32	26.11	-1%
<b>Margins</b>			
Gross	48.6%	42.2%	
Operating	13.3%	7.0%	
Net	18.9%	0.2%	

The following charts illustrate the trend in gamma probe unit sales (Figure 2), expense control (Figure 3), and most importantly operating cash flow (Figure 4). As shown in Figure 4, prior to 2001, operating cash flow per share has been better than EPS, which is a good indicator of financial health. In 2001, operating cash flow per share was less than EPS largely because NEOP increased inventory levels in order to avoid potential shortages (like it experienced in 2Q01).

Figure 2

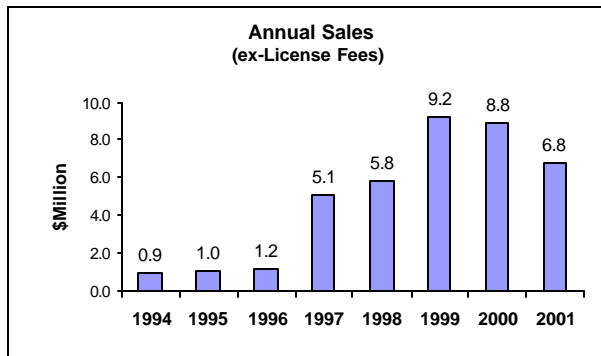


Figure 3

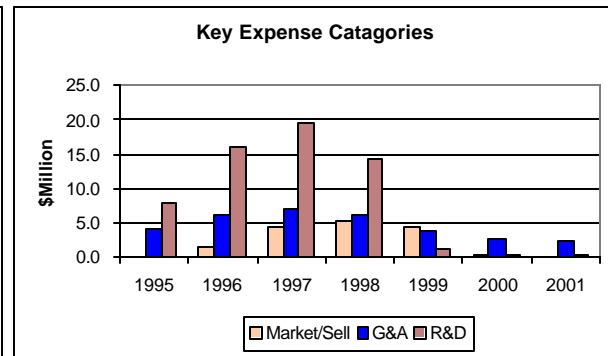
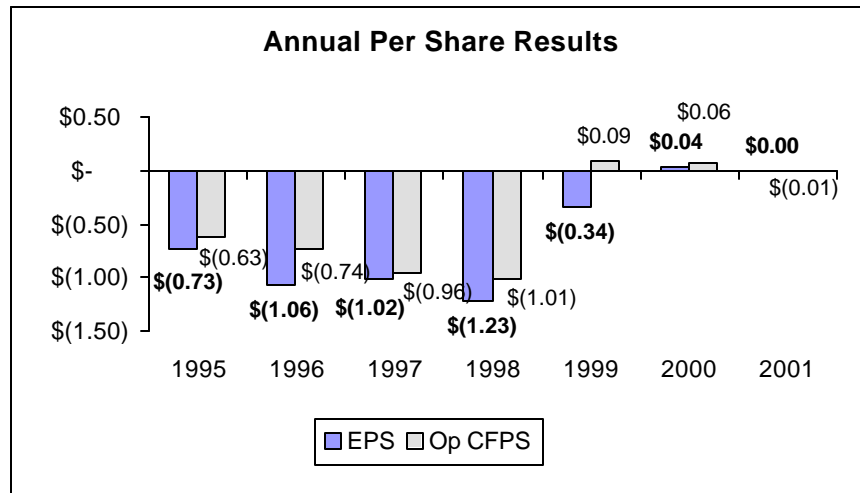


Figure 4



**Cardiosonix**

NEOP completed the acquisition of Cardiosonix (formerly known as Biosonix) in late December 2001. Cardiosonix is a development-stage medical device company that has developed devices that provide faster and more precise ways to measure blood flow in critical situations. Several of the devices can provide this data non-invasively.

The Market

The need to accurately measure blood flow has increased as the incidence of cardiac disease has risen and as new operating techniques have been developed. Some of the most critical procedures requiring accurate blood flow data are graft bypass, Cardio Output (CO), organ transplants, vascular surgery, and neurosurgery. The Center for Disease Control estimated that

in the US in 1999 that there were 60-million physician office visits and over 6 million outpatient department visits with a primary diagnosis of cardiovascular disease. Industry analysts estimate that the rate of cardiovascular disease for the rest of the world is twice that of the US. NEOP estimates that the worldwide market potential for bloodflow measuring devices to be \$1.5 billion.

### Products

Cariosonix's products have three key competitive advantages:

- The ability to provide an accurate, real-time measurement of blood flow
- In many situations
- Without having to isolate target vessels or conduct other invasive procedures.

These devices employ a unique Angle-independent Doppler Blood Flow (ADBF(TM)) technology that allows for more precise and real-time blood flow volume and velocity readings. Most current applications of Doppler technology for blood flow measurement are angle-dependent and thus more prone to estimation errors and potential inaccuracy. At present, Cariosonix has three products in the late stages of development and pre-commercialization that are designed to provide blood flow measurement and cardiac output information to physicians in cardiac/vascular surgery, neurosurgery and critical care settings.

**FLOWGUARD(TM)** is designed to allow neurosurgeons and neurologists, as well as intensive care unit or emergency room physicians, to continuously and non-invasively measure global cerebral blood flow in a simple and real-time manner. FlowGuard consists of an angle-independent ultrasound probe that obtains signals directly from the carotid artery and is designed primarily for use in monitoring head trauma patients in neuro-intensive care units and emergency rooms.

Other systems that monitor capabilities of the brain are significantly more invasive, expose the patient to incremental risk or are inherently complicated, and provide only an indirect estimation of blood flow. Some medical devices use an estimated measurement of blood flow velocity to create an index of blood flow but do not account for instantaneous changes in vein capacity. We are not aware of a competing system, in the market today, that can provide the real-time, bedside, non-invasive, continuous and direct measurements that Flowguard can.

**INFLOW(TM)** (Investigational) is being designed to permit cardiovascular surgeons and assisting physicians to obtain intraoperative volume blood flow readings in various targeted blood vessels within seconds. The system consists of an angle-independent ultrasound probe and digital numerical displays of blood flow rate that will provide the surgeon real time and quantitative measurements on the target vessel. Quantifying blood flow is crucial during anastomotic or other bypass graft procedures to determine adequate blood flow. Measurement is advisable whenever a blood vessel is exposed, but not generally followed in current practice.

Currently, the surgeon generally resorts to using his eyes and fingers in a process called finger palpation to qualitatively estimate blood flow. InFlow offers the surgeon immediate and simple quantitative assessment of blood flows in multiple blood vessels and grafts. The primary advantage of finger palpation is that it is fast and simple. But the disadvantages are that it requires a good deal of experience, it is difficult to perform in vessels embedded in tissue, it can become difficult to interpret in large vessels, and it

permits only a very qualitative and subjective assessment. A significant partial blockage (or even a total occlusion) will result in significant vessel "inflation" and strong palpations that could mislead the surgeon.

Instead of such a subjective and difficult practice, InFlow is designed to allow the surgeon to rely on real time and objective measurement. In addition, InFlow allows for immediate cardiac output assessment during cardiac surgery, which is particularly crucial when the patient is taken off the pump and returned to beating heart condition. Other technologies that attempt to measure intraoperative blood flow directly are often invasive and impractical when multiple vessel measurements are required. They are, therefore, not used routinely in the operating room, so surgeons most often resort to using their eyes and fingers to qualitatively measure blood flow.

**BIOFLOW(TM)** (Investigational) is being designed as a transesophageal cardiac function monitor for measuring blood flow in the descending aorta in critical care settings. The system employs a special transesophageal catheter for measuring blood flow in the descending aorta for cardiac output calculations. The system is designed for bedside use in intensive care settings when cardiac output and function monitoring is essential. The procedure of transesophageal monitoring is a well-recognized technique, particularly for echocardiography of the heart.

Other methods of determining cardiac output are highly invasive and do not provide the real-time and accurate readings that BioFlow provides. One technique, Thermodilution, involves placing a sensor into the heart via insertion into a major artery, injecting cold saline into the pulmonary artery at a fixed temperature, and calculating the time it takes for the temperature to return to normal, which is *thought* to be proportional to the volume flow of blood.

The main limitations of this procedure are:

- Highly invasive
- Measurements are not real-time
- Subject to errors: must be done three times to produce an estimate
- Does not allow for continuous monitoring
- Requires and experienced staff
- Linked to increased morbidity and mortality.

Bioimpedance is another, relatively new, technique that is gaining acceptance because it is non-invasive and simple to use. This technique involves attaching electrodes to the chest and neck to measure phasic changes in conductivity. However, these calculations are based upon empiric assumptions and can only be used in a few circumstances. For example, this procedure could not be used during cardiac surgery or under conditions that limit access to electrode locations.

The ability to provide direct/real-time measurement in both operating rooms and ICUs are two key competitive advantages for BioFlow.

### Regulatory Approvals

Currently, the FlowGuard device has received CE mark regulatory clearance for marketing in the European Union (EU) as well as FDA 510(k) clearance for marketing in the United States. The InFlow and BioFlow are not currently cleared for marketing in any market.

NEOP's strategy related to Cardiosonix products for 2002 has three primary objectives:

- Aggressively pursue regulatory clearance for the rest of Cardiosonix' current products in the U.S. and EU;
- Place devices with thought leaders in the neurosurgical and cardiac arenas for evaluation in preparation for full scale commercial launch; and,
- Initiate the first commercial sale of Cardiosonix products in the EU and the U.S. in the fourth quarter of 2002.

There can be no assurance that any of the Cardiosonix products will achieve regulatory approval, or if approved, that such products will achieve market acceptance. We strongly recommend that investors read the Company's 10-K for additional information on the risks regarding both the Cardiosonix and gamma probe product lines.

### Marketing

We expect NEOP to follow the same marketing strategy it employed with its gamma probes;

- Work with "thought leaders" in the cardiac and neurosurgical fields in order to accelerate clinical evaluations and promote product acceptance, and
- Contract with an external medical marketing organization

With the goal of commercializing Cardiosonix's products in 4Q02 and becoming cash flow positive in the second half of 2003, we expect the company to select a marketing firm relatively soon. FlowGuard will likely be the first product to be marketed since it has already received regulatory approvals in Europe and the US.

### Peer Group

We have found two publicly traded medical device companies that are comparable to Cardiosonix, Arrow International (NASDAQ NM: ARRO) and CardioDynamics International Corporation (NASDAQ NM: CDIC). Both of these firms compete with Cardiosonix in the critical care monitoring niche.

Here is a summary of their business and product lines.

ARRO: Develops, manufactures and markets a range of disposable catheters and related products for critical and cardiac care. ARRO's products; measure blood flows, administer fluids and drugs, monitor patients, and provide pain management. Their fiscal year ends in August and sales through November 2001 were \$336 million (+5.0%). ARRO is not a good direct peer, but it does provide a good data point for the sector.

CDIC: Develops, manufactures and markets heart monitoring devices that provide data on a wide range of parameters relating to blood flow and heart function. CDIC's devices are non-invasive. The company's main products are the BioZ System, BioZ Portable, and

BioZ.com and use a technology called thoracic electrical bioimpedance and are an alternative to right heart catheterization.

### Other Developments: Fusion Equity Line of Credit

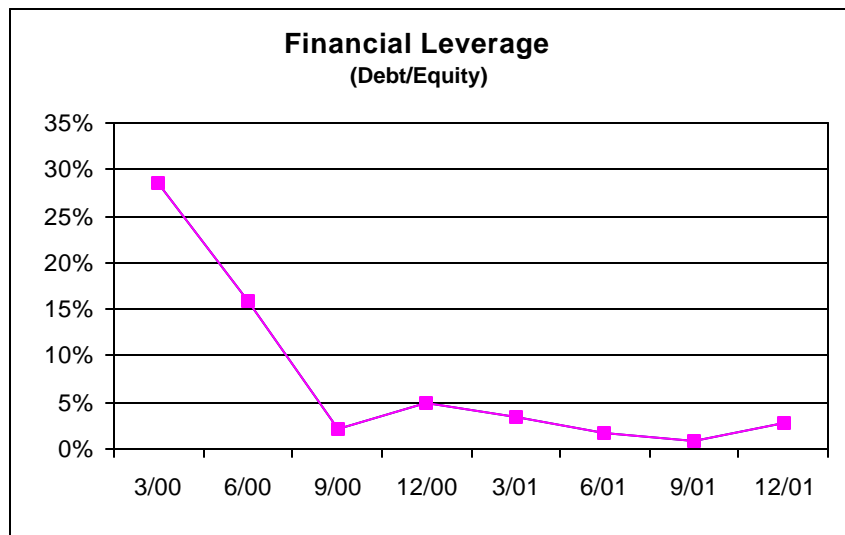
On November 19, 2001, NEOP entered into a common stock purchase agreement with Fusion Capital II, LLC ("Fusion") that could provide up to \$10 million in funds. Under the 40 month agreement, the stock price will be determined by the lower of either; (1) the NEOP's share's closing price on the prior day, or (2) the average of the three lowest closing prices for the preceding 12 days. The minimum price is \$0.30 or \$0.20 if both parties agree. While Fusion can sell the shares acquired under the line at any time, it also holds 449,438 NEOP shares (issued as a commitment fee) that cannot be sold until after the line expires.

We think this line will be used mainly to provide funds, if needed, to develop the Cardiosonix product line. While utilizing this type of funding mechanism will improve NEOP's capital structure, it does pose a material dilution risk to current and future shareholders. Investors should read NEOP's 10-K for more details.

### Financial Condition

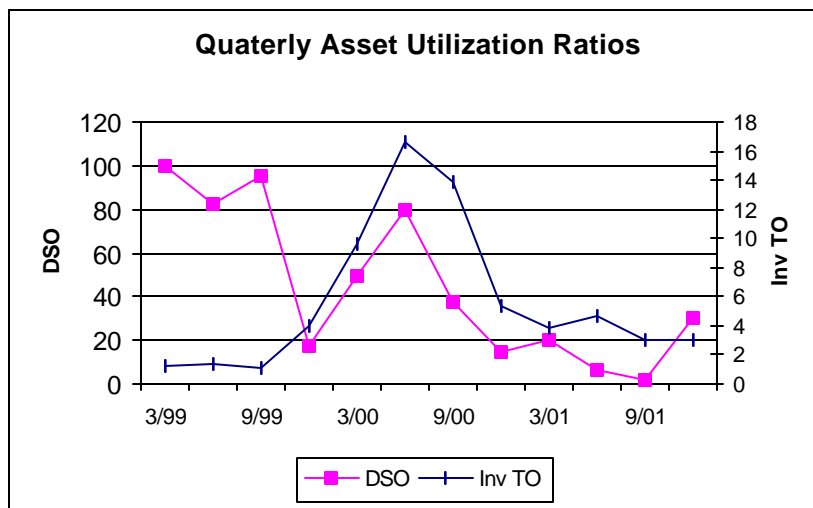
Despite a challenging 2001, operating cash flows were sufficient to fund operations. As shown in Figure 5, financial leverage remained relatively even with 2001 while Times Interest Earned (the quarter's EBITDA before one time charges/interest expense for the quarter) remained more than adequate.

Figure 5



Cash flows remain strong as the result of receivables and inventory management. As shown in Figure 6, both days sales outstanding and inventory turnover remain low relative to historical levels. DSO spiked in 4Q01 due to EES's ordering practices. While this causes volatility in DSO, payments continue to be received per the marketing agreement. Inventory turns slowed in the second half of 2001 as NEOP established a "safety cushion" of critical components in order to avoid shortages that it experienced in early 2001.

Figure 6



### Peer Group Comparison

As shown in Table 3, it was a difficult year for NEOP and the sector. Even companies that had tremendous sales growth experienced significant losses during 2001. However, NEOP did end the year with less leverage.

Table 3: Sector Comparables (Million except ratios and EPS)			Performance Last 12 Months (LTM)							
			Revenues (Million)	% Chg	Net Margin	CF/ EPS	EPS % Chg	Debt/ Capital	Interest Cover	
<b>Company</b>	<b>Ticker</b>	<b>Price</b>								
<b>NEOPROBE CORP.</b>	<b>NEOP</b>	<b>\$ 0.38</b>	<b>\$ 6.8</b>	<b>-24%</b>	<b>-37.9%</b>	<b>NM</b>	<b>\$ 0.00</b>	<b>-98%</b>	<b>0.5%</b>	<b>168.0</b>
PEER GROUP (see below)		\$ 11.77	\$ 49.1	43.4%	-361.5%	145.0%		5%	18.5%	31.8
JOHNSON & JOHNSON	JNJ	\$ 62.70	\$33,000	10%	17.2%	130.0%	\$ 1.93	18%	8.4%	52.6
<b>Peer Group</b>										
ARROW INT'L	ARRO	\$ 45.69	\$ 341.0	6%	13.9%	150.0%	\$ 2.19	2%	0.2%	30.5
FISCHER IMAGING	FIMG	\$ 11.80	\$ 48.0	-5%	6.8%	140.0%	\$ 0.37	32%	2.7%	33
IGEN INT'L	IGEN	\$ 37.22	\$ 37.0	28%	-126.4%	NM	\$ (2.66)	-34%	86.7%	-
TRIPATH IMAGING	TPTH	\$ 4.85	\$ 27.0	-17%	-80.4%	NM	\$ (0.62)	-63%	1.0%	-
CARDIODYNAMICS INT'	CDIC	\$ 4.05	\$ 20.0	38%	-3.6%	NM	\$ (0.01)	90%	-	-
VISTA MEDICAL TECH	VMTI	\$ 4.10	\$ 9.3	43%	-34.4%	NM	\$ (0.65)	29%	-	-
CHROMAVISION MED S	CVSN	\$ 4.88	\$ 4.9	308%	-277.6%	NM	\$ (0.67)	9%	-	-
MATRITECH	NMPS	\$ 2.11	\$ 2.3	63%	-378.3%	NM	\$ (0.31)	-15%	1.9%	-
PHOTOELECTRON	PHX	\$ 2.40	\$ 1.0	-30%	-910.0%	NM	\$ (0.94)	-9%	-	-
CELSION	CLN	\$ 0.62	\$ 0.4	0%	-1825.0%	NM	\$ (0.09)	na	-	-

(Source: Baseline, researchstock.com)

## Outlook

We lowered our 2002 forecast to a net loss per share of \$0.11 from \$0.02 mainly due to lower sales volumes and increased R&D costs. Here is a summary of our key assumptions:

Lower sales: We think 2003 sales will be lower than in 2001 as the result of continued weak demand and the change in minimum sales terms of the EES contract. Unit volumes are expected to be lower in 2002 than in 2001 because hospitals that have not yet purchased units are probably waiting for additional test results that may not be published until 2003.

The distribution agreement with EES does not end until 2004, but the minimum-ordering requirement will be met sometime in 3Q02. This means that after that point in 3Q02, EES will not be required to make minimum quarterly purchases from NEOP. In a worst-case scenario, if end-user demand remains slow and EES decides it has sufficient inventory, it is possible that NEOP gamma probe sales could drop significantly in 4Q02. We currently forecast 4Q02 gamma probe sales of \$1.4 million, but actual sales could be significantly lower. We also do not expect RIGS to generate any license/royalty revenues (NEOP received \$25,000 in RIGS related royalties in 2001).

We also do not forecast any Cardiosonix revenues in 2002, which may be overly conservative. Management's goal is to have successfully initiated Cardiosonix marketing in 4Q02, but we have assumed no sales until 2Q03. It is possible that Cardiosonix sales could occur faster than we forecast. For example, Cardiodynamics sold 29 units in the first quarter after they received FDA clearance for their blood flow measuring device. But with so many variables involved (the timing of FDA approval, who will be marketing the products, and market demand), we chose to err on the conservative side.

Gross Margins: We lowered our gross margin assumption because we expect pricing pressure to continue in 2002. This pressure could come from lower average selling prices (to entice new buyers) and/or from higher manufacturing costs.

SG&A Expense: We assume that SG&A will be flat with 2001 as Management continues to keep a tight rein on costs and marketing is done by EES.

R&D: We expect R&D to increase to \$4 million in 2003 and \$2 million in 2004 as the Company develops the Cardiosonix product line. We have also assumed that EES will not provide R&D reimbursement to NEOP, which amounted to \$125,000 in 2001.

Interest Expense: Based upon our current forecast, we do not expect NEOP to have to draw upon the Fusion equity line in 2002 or 2003. We do expect the Company to tap its line of credit on a periodic basis and assume an annual interest rate of 8%. We have not included any interest income in our projections.

Diluted shares Outstanding: Because we do not expect NEOP to tap the Fusion equity line, we assume that diluted shares outstanding will approximate shares outstanding as of December 31, 2001 (36.5 million).

Our 2003 EPS forecast of a net loss of \$0.02 per share is based upon a nominal increase in unit sales, G&A expense increased as the rate of inflation (3.0%), and the assumptions noted above. It also assumes that 17 Cardiosonix units are sold under a marketing arrangement similar to the

EES contract, at an average selling price of \$13,500 (a 50% discount to an average "retail" price of \$27,000). As noted above, this could be viewed as an overly conservative assumption.

Table 4 contains our annual forecast and Table 5 has our outlook for the next four quarters.

<b>Table 4: Annual Income Statement &amp; Forecast</b>							
(\$Million, except per share data)							
	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002e</b>	<b>2003e</b>
Unit Sales: ILM	5.13	5.83	9.25	8.84	6.76	<b>5.50</b>	<b>5.60</b>
Bloodflow						<b>0.0</b>	<b>2.30</b>
Lic Fees	0.00	0.00	0.20	0.88	0.83	<b>0.80</b>	<b>0.80</b>
Total Revs	5.13	5.83	9.45	9.71	7.58	<b>6.30</b>	<b>8.70</b>
COGS	1.58	1.40	4.51	4.99	4.39	<b>3.74</b>	<b>3.81</b>
Gross Margin	3.55	4.43	4.94	4.72	3.20	<b>2.56</b>	<b>4.89</b>
Market/Sell	4.31	5.27	4.47	0.28	0.00	<b>0.04</b>	<b>0.00</b>
G&A	6.85	6.09	3.74	2.68	2.32	<b>2.33</b>	<b>2.32</b>
R&D	19.66	14.37	1.31	0.47	0.34	<b>4.33</b>	<b>2.30</b>
Discont. Ops/R&D	0.00	7.18	0.48	0.00	0.89	<b>0.00</b>	<b>0.00</b>
Operating Income	-27.27	-28.47	-5.06	1.29	-0.35	<b>-4.14</b>	<b>0.27</b>
Interest Inc	0.00	0.60	0.10	0.21	0.13	<b>0.03</b>	<b>0.00</b>
Interest Expense	0.00	-0.19	-0.08	-0.03	-0.01	<b>-0.06</b>	<b>-0.25</b>
Other Income/(Exp.)	4.02	0.03	0.16	0.37	0.25	<b>0.16</b>	<b>0.00</b>
PreTax Income	-23.25	-28.03	-4.17	1.84	0.02	<b>-4.01</b>	<b>0.01</b>
Inc Taxes	0.00	0.00	0.00	0.00	0.00	<b>0.00</b>	<b>0.00</b>
Net Inc	-23.25	-28.03	-4.17	1.84	0.02	<b>-4.01</b>	<b>0.01</b>
Stock Conversion	0.00	0.00	-3.72	-0.76	0.00	<b>0.00</b>	<b>0.00</b>
Net to Comm SH	-23.25	-28.03	-7.90	1.08	0.02	<b>-4.01</b>	<b>0.01</b>
<b>EPS-Dil</b>	\$ (1.02)	\$ (1.23)	\$ (0.34)	\$ 0.04	\$ 0.00	\$ <b>(0.11)</b>	\$ <b>0.00</b>
<b>Shares</b>	22.7	22.8	23.0	26.3	26.0	<b>36.5</b>	<b>36.5</b>
<b>Growth Rates</b>							
Unit Sales	337.9%	13.7%	58.5%	-4.4%	-23.5%	<b>-18.6%</b>	<b>43.5%</b>
Operating Income	-16.8%	-4.4%	82.2%	125.5%	-127.4%	<b>1074.7%</b>	<b>-106.5%</b>
Net Income	-10.9%	-20.6%	71.8%	113.6%	-98.6%	<b>-26820.8%</b>	<b>100.3%</b>
EPS	3.7%	-20.0%	72.0%	111.9%	-98.6%	<b>-19168.4%</b>	<b>100.3%</b>
<b>Margin Analysis</b>							
Gross (ex-Lic Fees)	69.3%	75.9%	51.2%	43.5%	35.1%	<b>32.0%</b>	<b>32.0%</b>
Operating	-531.7%	-488.1%	-54.7%	14.6%	-5.2%	<b>-75.2%</b>	<b>4.8%</b>
Net	-453.3%	-480.6%	-45.1%	20.8%	0.2%	<b>-72.9%</b>	<b>0.2%</b>
<b>Boldface data are estimates</b>							

<b>Table 5: Quarterly Forecast</b>								
(\$ Million)	<b>1Q01</b>	<b>2Q01</b>	<b>3Q01</b>	<b>4Q01</b>	<b>1Q02</b>	<b>2Q02</b>	<b>3Q02</b>	<b>4Q02</b>
Sales	1.394	2.077	1.592	1.695	<b>1.300</b>	<b>1.500</b>	<b>1.300</b>	<b>1.400</b>
Lic Revs	0.225	0.200	0.200	0.200	<b>0.200</b>	<b>0.200</b>	<b>0.200</b>	<b>0.200</b>
Total Revs	1.619	2.277	1.792	1.895	<b>1.500</b>	<b>1.700</b>	<b>1.500</b>	<b>1.600</b>
COGS	0.948	1.441	1.090	0.906	<b>0.884</b>	<b>1.020</b>	<b>0.884</b>	<b>0.952</b>
Gross Margin	0.671	0.836	0.702	0.989	<b>0.616</b>	<b>0.680</b>	<b>0.616</b>	<b>0.648</b>
Market/Sell	0.000	0.000	0.000	0.000	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.040</b>
G&A	0.570	0.592	0.539	0.619	<b>0.585</b>	<b>0.580</b>	<b>0.585</b>	<b>0.580</b>
R&D	0.074	0.097	0.030	0.143	<b>1.050</b>	<b>1.050</b>	<b>1.050</b>	<b>1.175</b>
Discnt Ops	0.000	0.000	0.000	0.000	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>
Operating Income	0.027	0.147	0.133	(0.658)	<b>(1.019)</b>	<b>(0.950)</b>	<b>(1.019)</b>	<b>(1.147)</b>
Interest Inc	0.050	0.033	0.029	0.016	<b>0.010</b>	<b>0.010</b>	<b>0.010</b>	<b>0.000</b>
Interest Expense	(0.003)	(0.004)	(0.002)	(0.002)	<b>(0.004)</b>	<b>(0.009)</b>	<b>(0.019)</b>	<b>(0.032)</b>
Other Income/(Exp.)	0.007	0.001	0.241	0.004	<b>0.040</b>	<b>0.040</b>	<b>0.040</b>	<b>0.040</b>
PreTax Income	0.081	0.177	0.401	(0.640)	<b>(0.973)</b>	<b>(0.909)</b>	<b>(0.988)</b>	<b>(1.139)</b>
Inc Taxes	0.000	0.000	0.000	0.003	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>
Net Inc	0.081	0.177	0.401	(0.643)	<b>(0.973)</b>	<b>(0.909)</b>	<b>(0.988)</b>	<b>(1.139)</b>
Stock Conversion	0.000	0.000	0.000	0.000	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>
Net to Comm SH	0.081	0.177	0.401	(0.643)	<b>(0.973)</b>	<b>(0.909)</b>	<b>(0.988)</b>	<b>(1.139)</b>
<b>EPS-Dil</b>	<b>\$ 0.00</b>	<b>\$ 0.01</b>	<b>\$ 0.02</b>	<b>\$ (0.02)</b>	<b>\$ (0.03)</b>	<b>\$ (0.02)</b>	<b>\$ (0.03)</b>	<b>\$ (0.03)</b>
Q/Q Growth	-110%	-72%	-21%	-188%	<b>-958%</b>	<b>-467%</b>	<b>-276%</b>	<b>27%</b>
<b>Growth Rates</b>								
Unit Sales	-13.2%	-17.3%	-25.1%	-34.6%	<b>-6.7%</b>	<b>-27.8%</b>	<b>-18.3%</b>	<b>-17.4%</b>
Operating Income	-149.1%	-74.0%	-69.4%	-292.4%	<b>-3874.1%</b>	<b>-746.3%</b>	<b>-866.2%</b>	<b>-74.3%</b>
Net Income	110.2%	-72.3%	-20.4%	-188.9%	<b>-1301.1%</b>	<b>-613.5%</b>	<b>-346.3%</b>	<b>-77.1%</b>
<b>Margin Analysis</b>								
Gross (ex-Lic Fees)	32.0%	30.6%	31.5%	46.5%	<b>32.0%</b>	<b>32.0%</b>	<b>32.0%</b>	<b>32.0%</b>
Operating	1.9%	7.1%	8.4%	-38.8%	<b>-78.4%</b>	<b>-63.3%</b>	<b>-78.4%</b>	<b>-81.9%</b>
Net	5.8%	8.5%	25.2%	-37.9%	<b>-74.8%</b>	<b>-60.6%</b>	<b>-76.0%</b>	<b>-81.3%</b>
<b>Boldface data are estimates</b>								

## Valuation

Valuing NEOP shares is especially difficult at this time. The Cardiosonix acquisition has made NEOP more of an early-stage development company and the uncertainties created by the maturing of the EES agreement also clouds our crystal ball. However, there is upside potential from the new product line and entry to a new and larger market. The broader product line and the blood flow market potential should provide some support for the stock during the coming 18 months when earnings will be offset by the investment in the bringing the new products to market.

We reduced our 12-18 month target price from \$0.80 to \$0.50 based upon our 2003 forecast and lack of information on which to base future sales. In one sense, this is a conservative estimate because it uses historical multiples which were based upon NEOP's single product line and it could be argued that the diversified product line and new market potential should be reflected in the valuation multiples. And, we have also used a conservative sales forecast for Cardiosonix. But until we have additional information on the resolution of the EES marketing agreement and blood flow product development, we will rely on the historical valuation ranges and our 2003 estimates. We did choose a target price near the high end of the range to somewhat reflect our

expectations of the future potential of Cardisonix. Table 6 illustrates how we determined our target range.

Price to:	LTM Range		Current LTM	Forecast Multiple	2003		Range
	Absolute	Average			Estimate		
<b>Sales</b>	3.2	2.3	2.0	3.0	\$ 0.24	\$ 0.71	
	1.1	1.2					1.5
<b>Book</b>	9.0	6.2	1.4	11.0	\$ 0.08	\$ 0.88	
	2.4	3.1					5.0
<b>EPS</b>	16.7	13.5	-3.5	16.0	\$ 0.00	\$ (0.01)	
	5.4	7.0					5.0

Average	High	\$ 0.53
	Low	\$ 0.25
	Average	\$ 0.39

As shown in Table 7, the valuation multiples of ARRO and CDIC indicate the future potential of the Cardisonix products.

Company	Symbol	Price		Market Cap.(MM)	P/B	P/S	Calendar P/E			PEG 2002
		\$	LTM %				2001	2002	2003	
<b>NEOPROBE CORP.</b>	<b>NEOP</b>	<b>\$ 0.38</b>	<b>-27%</b>	<b>14</b>	<b>1.4</b>	<b>2.0</b>	<b>9.3</b>	<b>-3.5</b>	<b>1043.9</b>	<b>0.02</b>
PEER GROUP AVERAGE		\$ 11.77	30%	255	12.7	13.0	-44.5	10.3	2.4	54.89
JOHNSON & JOHNSON JNJ		\$ 62.70	38%	192,328	7.9	5.9	32.5	32.5	28.2	
<b>Peer Group Detail</b>										
ARROW INT'L	ARRO	\$ 45.69	27%	999	2.9	2.9	21.4	18.6	na	124.21
FISCHER IMAGING	FIMG	\$ 11.80	192%	108	3.4	2.3	31.9	31.9	13.258	na
IGEN INT'L	IGEN	\$ 37.22	97%	817	-	22.2	-14.0	-17.9	-109.47	82.07
CHROMAVISION MED	TPTH	\$ 4.85	39%	182	2.3	6.7	-7.8	-10.1	80.833	44.75
CARDIODYNAMICS INT' CDIC		\$ 4.05	19%	187	10.3	9.3	-405.0	57.9	17.609	-7.23
VISTA MEDICAL TECH	VMTI	\$ 4.10	17%	20	6.5	2.2	-6.3	na	na	na
CHROMAVISION MED SCVSN		\$ 4.88	17%	99	37.8	20.3	-7.3	-18.8	9.9592	30.67
MATRITECH	NMPS	\$ 2.11	-30%	64	11.5	27.3	-6.8	na	na	na
PHOTOELECTRON	PHX	\$ 2.40	-31%	24	-	24.0	na	na	na	na
CELSION	CLN	\$ 0.62	-43%	56	27.0	-	-6.9	na	na	na

Source: Baseline, Company data, and researchstock.com.  
The PEG is the ratio of the 2002 P/E to the expected EPS growth in 2002.

### Risk Consideration

Investors need to consider the following risks before investing:

The Company has two main product lines: gamma probes that are currently on the market and blood flow measuring devices that are under development. Gamma probe sales declined in

2001 due to lower contractual pricing with EES (see below) and lower unit volumes. It is unknown when blood flow measuring devices will be marketed.

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 October 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.

Cardiosonix is located in Israel and is subject to political and war risk. The some of the management of the company is subject to being called into the army in the event of war. NEOP periodically "backs up" Cardiosonix's critical information in the US.

NEOP is committed to leveraging its expertise and expanding its product line. If there are promising results from one of these initiatives, the Company will need to seek additional funds, most likely via a stock offering. Such an offering would probably be dilutive to current shareholders. The \$10 million Fusion equity line of credit is expected to be sufficient to fund current needs, and taping the line will cause dilution to current shareholders. It is also possible that the Company make seek additional funds in order to pursue other product development projects.

It is difficult to forecast future sales because detailed information is not disclosed. Our forecasts assume a modest steady growth, but actual sales levels could be more erratic and cause EPS to vary from our forecast.

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.

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 and thus subject to volatility. Average daily volume for the last 12 months has been about 47,000 shares.

The Company is not widely followed by Wall Street analysts. Consequently, it is possible that the stock could remain undervalued due to a lack of analyst support.

Investors should read the Company's SEC filings and consider their risk tolerance, cash needs, and investment time horizons before investing in this, and any small cap stock.

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