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HMSY - Q2 2016 HMS Holdings Corp Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to HMS second-quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded. I would like to introduce your host for today's conference, Mr. Dennis Oakes. Sir, please begin

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Dennis Oakes - ***HMS Holdings Corporation - SVP of IR***

Thank you. I thank you, everyone, for joining the HMS second-quarter 2016 earnings conference call.

With me this morning are Bill Lucia, our Chairman and CEO, and Jeff Sherman, our Chief Financial Officer. Earlier today, we distributed our quarterly earnings release through our website HMS.com, under Investor Relations tab, and posted an investor presentation containing supplemental information, though we will not make specific reference to it in our prepared remarks. This call is being webcast and can be accessed by the Events and Presentations tab on our website. And replay of the call be posted later this morning.

Some of the information we will discuss today including the Company's future expectations, plans, and prospects is considered forward-looking statements under the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. These statements are based on the Company's current expectations and actual events may differ materially from those expectations. We refer to you the Company's filings with the SEC, including our Annual Report on Form 10-K and our quarterly reports on Form 10-Q. Those filings are identify important risk factors that could cause actual results to differ materially from those contained in the Company's projections or forward-looking statements.

All information discussed on this call is based on the information available to us as of today, August 5, 2016. And the Company disclaims any intent or obligation to update any forward-looking statements as a result of the developments occurring after today's call, except as required by law.

Finally, we may refer to certain non-GAAP measures during the call. And our earnings release and investor presentation both include a reconciliation of those measures to GAAP.

For the Q&A session, we ask that you limit your inquiries to one question and one follow-up, so we can get through the full list in a timely fashion. We are now ready to begin. Bill?

Bill Lucia *- HMS Holdings Corp - President and CEO*

Thank you, Dennis, and good morning, everyone. The clear highlight of our second-quarter, is the remarkably strong commercial health plan sales. We added approximately 15 million new at risk and administrative service only, or ASO, lives, which takes total unique health plan lives of the contract above 100 million for the first time in Company history.

Though, new lives, the sale was to existing customer from we already provide some services for their Medicare and Medicaid members. We also sold incremental products to current health plan customers, covering approximately 3 million of their members. Those sales represent one or more additional products sold to a population for which we are already doing some work, such as adding long-term care audits to existing clinical claim reviews. Though these sales are expected to have little revenue impact this year, they are a clear indication of the sustainability of our commercial health plan growth.

Adding 15 million new commercial lives is a huge win. But what is most significant is the fact that these are at risk and ASO commercial live, not Medicaid Managed Care or Medicare Advantage. And the work we have been contracted for is payment integrity, including complex clinical reviews and credit balance and hospital bill audits.

Though we continue to experience growth in our COB product line, it is a more mature business. So payment integrity is most frequently where our health plan growth is coming from. In fact, over 90% of sales in the quarter were for payment integrity products as is approximately 60% of today's sales pipeline.

Up to this point, very few of our health plan lives were among the true commercial at risk or ASO populations, but we continue to believe there is substantial opportunity for more of these sales. Particularly, in light of increasing pressure faced by many of the larger national and regional plans to contain costs. A variety of factors are contributing to that pressure, including expensive new members enrolled through the healthcare exchanges, increased regulatory burdens, and growing demand from self-insured large employers for more cost containment.

There is little chance these cost concerns will subside, as the most recently released annual healthcare spending projections from the CMS Office of the Actuary suggests national health spending will increase at an average rate of 5.5% per year through 2025. Well in excess of projected GDP growth.

Our financial performance in the quarter was also very solid. Through the first six months of the year revenue in our commercial health plan business was up just over 20%, which is the top end of our full-year guidance range. Though the comps to get tougher in the back half of this year, we are confident we can achieve our full-year objective of 18% to 20% commercial health plan revenue growth. State revenue was inline with our expectations. Medicare RAC revenue was modestly higher than we anticipated, despite the new ADR limits which began in January. And cash flow from operations was particularly strong. Jeff will provide more detail on each of those items in his remarks.

We also had two important wins in the state TPL market in the second quarter. Ohio, one of our top-10 states by revenue, notified us in May of their intent to award HMS a new five-year contract beginning June 30, 2017 when our current agreement ends.

We are also very pleased to again be serving the state of Louisiana, pursuant to a competitive bid for which we received notice of a five-year contract award in mid-May. This follows the period of approximately 18 months during which the state handled their Medicaid TPL work in-house. Our new contract began on July 1. And it will represent a larger opportunity than our prior work for Louisiana, since the state recently became the 31st to expand their Medicaid program under the Affordable Care Act. Nearly 250,000 of an estimated 375,000 newly eligible individuals have joined the state's Medicaid rolls since the June 1 start of the expansion.

As you know, our current TPL contract with the state of New Jersey was recently extended again through the end of this month. We are in active discussions with the State about the future direction of that work and expect to have clarity about their intentions very soon. We are hopeful the current discussions will lead to a negotiated contract, but even if the state decided to formally start the procurement over, the process would not likely conclude before the end of this year. As a result, we are now contemplating a full-year of New Jersey state revenue in our projections.

I want to touch briefly on two remaining items before turning the call over to Jeff. First, is our recent selection by CMS as one of seven companies eligible to compete over the next 10 years for program integrity projects targeted at fraud, waste and abuse in Medicare and Medicaid. The award is the first step in an effort by CMS to consolidate multiple programs into a new unified program integrity contract, or UPIC. In addition, at CMS UPIC contractors will coordinate activities with other federal, state and local agencies.

Though initially, only an opportunity to bid and compete for future business, as a pre-approved vendor, this is further recognition of the expertise HMS has in the detection, prevention, and investigation of fraud, waste and abuse. The UPIC award is particularly gratifying following our selection by CMS last September as a trusted third-party subcontractor to work with the healthcare fraud prevention partnership.

Secondly, I want to provide an update on our prepaid clinical review product. Following the successful conclusion of the pilot project for our initial Medicare advantage customer, we have a second Medicare plan up and running and we are currently in implementation for both Medicaid and ASL plans. As described previously, our focus for prepaid work to date is principally on hospital claims, but our product road map does include plans to move more automated edits and other provider and claim types into the prepaid solution as we evolve this product with our clients over the next few quarters.

Our prepaid product requires tight systems integration with our customers and quick turnaround times in order to meet state prompt pay laws. We appear to have a first mover advantage in this space for clinical review of institutional claims and do have the customer relationships necessary for ongoing sales of our prepaid product in the coming months. Such new sales should begin to be reflected in a meaningful way in our health plan revenue growth next year.

Jeff will now provide his perspective on the quarter. Jeff?

Jeffrey Sherman - ***HMS Holdings Corp - CFO***

Thank you, Bill, and good morning. Our financial performance in the second quarter was very strong by any measure. Adjusted EBITDA of $32 million was a significant step up from the prior quarter and the year-ago second quarter. Cash flow from operations was $45 million, due primarily to heightened cash collections in the quarter and a decline in accounts receivable of $13 million. As a result, balance sheet cash at June 30 was $188 million compared to $143 million at the end of the first quarter.

Core second-quarter revenue was essentially inline with our expectation, though two items require explanation. Medicare RAC revenue of $4 million included some reconciliation of older outstanding claims completed prior to expiration of the current contract, which ended on July 31, as well as new audits finished in the second quarter. We were able to complete more auditing in the quarter than we originally expected, with additional work in areas not impacted by the ADR limits and CMS approval of incremental audits or scenarios where previously approved but the number of audits was limited.

At the moment, CMS has not made the new awards nor have they extended the old contracts, so we currently expect to generate little Medicare RAC revenue in the next quarter. Even if new awards were announced very soon and we successfully secured one or two regions, the would requirements start-up period would preclude any meaningful revenue in the third quarter.

Going into the second quarter, we expected state revenue would be flat to up slightly compared to $50.7 million in the first quarter. A one time acceleration of approximately $5.5 million of subrogation related revenue pushed state revenue in the quarter to $57.6 million.

We have spoken on a number of occasions about an ongoing Companywide effort to improve the efficiency of all of our systems and to increase product yield. During the second quarter, we completed the build out of a new system and data tracking mechanism for a portion of our subrogation business which significantly enhanced our ability to analyze key elements of the subrogation process. Subrogation cases often stretch out over many months and in some cases years and the average is close to one year in duration.

Historically, we have used cash collections as a trigger for revenue recognition in our segregation business. Utilizing the new system and new analytical tools, we identified the portion of outstanding subrogation cases where final terms had been reached. Since all of their criteria for revenue recognition were met, we recorded revenue in the quarter for those cases. It is important to understand all the $5.5 million would have flowed into revenue over the next few quarters, and we estimate about half would have been received in cash and recorded to revenue by the end of this year. So the incremental revenue impact for full-year 2016 is very small.

As Bill mentioned, we hope to be able to favorably conclude discussions about a new TPL agreement with the state of New Jersey soon. But even a rebid would likely result in contract extensions through the end of the year, so we are updating our full-year 2016 state revenue projection to include a full year of New Jersey revenue.

As we have previously explained, a large Medicaid enrollment both from the Affordable Care Act resulted in a temporary increase in our state revenue for 2014, up 9% compared to the prior-year and into the early part of 2015. Since three of four new Medicaid enrollees now end up in managed care plans, the longer-term benefit of the ACA expansion accrued to our commercial health plan business not the state business.

Because New Jersey had a disproportionately high enrollment increase in 2014, about 30% compared to the national average of 20%, and because the bulk of the TPL work we do for New Jersey is cost avoidance rather than post-payment recoveries, our New Jersey TPL revenue was significantly higher during 2014 and somewhat higher during 2015 than the average and preceding years. As result, we expect total New Jersey TPL revenue this year to decline since the scope of the work is unchanged.

Looking more broadly at our state government revenue going back to 2013, before the Medicaid expansion, is also instructive for perspective. Total state revenue for that year was $207.5 million, [pinning] that forward at 2% per year, consistent with our long-term view that our state TPL business is a low single-digit grower, corrects for what was effectively a one-time state revenue benefit during 2014 and early 2015 caused by the ACA expansion. Doing so produces a total of roughly $220 million for 2016 or a quarterly run rate of approximately $55 million, which is consistent with our expectation for state revenue over the second half of this year.

Commercial revenue through the first six much of 2016 is at the high end of our guided range compared to the same period last year. Recognizing there is a steep ramp in the second half of this year to achieve our full-year projected growth of 18% to 20%, we remain confident in our ability to get there based on the planned implementation schedule for already sold business. Our confidence is boosted by the success of our integrated initiative, which continues to increase our quarterly capacity to onboard new business.

Implementations in the first half of this year, for example, were about 25% higher than the first six months of 2015. And we're continuously shorting the duration for both payment integrity and coordination of benefits implementations, so expect to continue making progress.

One important key to streamlining and improving the implementation process has been the adoption of new technology, which permits us to onboard data more quickly and efficiently. Doing so is generally the largest barrier to getting from contract signing to revenue production, so we are constantly looking for new and innovative ways to improve data intake. The cleaner and more complete our customers' data is the higher the yield on our work. We are intensely focused, therefore, on usability of the data so our proprietary matching algorithms and payment integrity engine can produce the greatest returns for our customers.

Though we still have some clients who occasionally put new projects on a temporary hold, which is most often due to concerns about provider abrasion or IT resource capacity, our implementation queue is sufficient to meet our full-year growth objectives. Expense management activities are ongoing and we will continue to deploy cost-saving strategies throughout the organization during the balance of this year. Our primary focus for 2016 is process improvements within our payment integrity product line to increase product yield an overall profitability. Though we also continue to look for and find yield improvement in our COB products.

Overall operating expenses in the second quarter declined sequentially, but we're up somewhat in the first half of this year compared to the same period last year. The biggest driver of the year-over-year increase was first-quarter expenses for temporary health and chart fees related to stepped of Medicare RAC activity, which generated $8 million in the first quarter revenue. But those expenses were not part of our run rate expectation for the latter half of this year. We are pushing hard to keep total operating costs over the balance of 2016 flat with the second half of 2015 despite the significant increase in health plan revenue we are expecting.

I mentioned at the outset of my remarks that our balance sheet strengthened meaningfully in the quarter. We continue to have excellent liquidity and combined with low leverage, we are well-positioned to execute on our primary capital allocation focus for 2016, which is to make an acquisition. We continue to be encouraged by the pipeline of opportunities we have identified, valuations, which more often reflects fair value than they did several months ago, and the prospect of leveraging our data and analytics capacity through interact organic growth.

As we have stated previously, our principal focus is acquisitions to complement our core business, expand our capacity to detect fraud, waste and abuse, and to begin building out a platform for natural adjacency's to our cost-containment work, such as member care management or member engagement.

Bill will now have brief closing remarks, and then we'll be ready for questions. Bill?

Bill Lucia *- HMS Holdings Corp - President and CEO*

Thanks, Jeff. The first half of 2016 has been a good story of growth and increasing profitability. And we expect our performance during the balance of this year will allow us to meet our full-year objectives, which Jeff spoke to earlier.

I want to conclude our remarks this morning by reminding everyone about the large runway we have in front of us. There are many factors creating opportunities for HMS. Let me focus on three this morning: the complexity of the healthcare system in which we operate, the demographics which are driving significant growth in government programs, and the unsustainable trajectory for overall healthcare spending.

Whether it be the introduction of ICD 10, proposals to move to more value-based reimbursement, individuals buying coverage on the still relatively new healthcare exchanges, or Medicaid expansion and the churn between these programs, the healthcare system is complex and constantly changing. We focus continuously on product innovation to improve our services, and we maintain regular dialogue with our customers in order to better understand their expectations and needs in this challenging environment. We believe we are very well positioned because of our data, technology, and analytics capacity to help solve our customers' challenges as they seek to better serve their members and manage their risks.

The markets we serve are growing and projected to continue growing for the foreseeable future, both from an enrollment perspective and in terms of total expenditures. We are working hard to position HMS to take advantage of these demographics by serving more of the Medicare Advantage and commercial at risk and ASO populations, as well as selling a relatively greater proportion of our payment integrity products compared with this historic product mix which was heavily weighted toward Medicaid COB. The second quarter commercial health plan sales I spoke about earlier, are a clear indication that we're taking advantage of these opportunities.

Our acquisition strategy is also directly linked to helping our clients better manage their members and their risk as those members move through our complex healthcare system, leverage our expanse of data and significant program expertise to help solve our clients most pressing problems, and continued refining our cost-containment solutions to enhance their financial success.

HMS is uniquely qualified to help bend the cost curve on behalf of our government and commercial customers. The work done every day that entire HMS team, utilizing the knowledge and data assets we have accumulated over the years makes the difference, not just for the bottom line of our direct customers, but also for their members who benefit from the programs funded or the dollars saved by our work. Recognizing that what we do matters is a source of great pride for each of us who work at HMS.

We remain excited about all of the growth opportunities in front of us as we tackle the ever-changing challenges of our healthcare system. As we look to a strong close for 2016, with good visibility on the incremental commercial health plan revenue expected in the third and fourth quarters, we remain focused on the need for short-term execution, while simultaneously pursuing our broader and longer-term strategic objectives.

That now concludes our prepared remarks. Nicey, we're ready for our first question.

QUESTION AND ANSWER

Operator

(Operator Instructions)

Steven Valiquette, Bank of America Merrill Lynch.

Steven Valiquette *- Bank of America Merril Lynch - Analyst*

Thanks. Good morning. Bill and Jeff, congrats on these results.

One of the questions we have here is, obviously, if you just use round numbers you'll need about $130 million in commercial revs in the back half of the year to meet the low end of that 18% to 20% growth guidance, versus the $111 million you posted in the first half. And it sounds like you have some visibility on that. But I just want to try to dive into that a little bit deeper, in terms of how much more new [signings] might you still need to get there, versus stuff you already have pretty high visibility on? It sounds like you're pretty confident, but just curious to get more color on that. Thanks.

Bill Lucia *- HMS Holdings Corp - President and CEO*

Yes -- very much like last year, our implementation schedule for sold business, and the projected revenue for the second half of the year has been heavily back-end weighted in 2016. The second half of 2015 revenue was about 19% higher than the first half -- it was $110 million versus $92 million. So basically, if we are able to achieve the same level of sequential growth this year, that would actually take us above our end of our guidance range. So we have good visibility in our revenue, expected over the balance of the year. It's really a matter of implementing already sold business. And it is reasonable to expect that we will have the typical year-end fourth-quarter push for revenue. So we do believe 18% to 20% growth is very achievable, based upon what we sold and what's in our implementation queue.

Jeffrey Sherman - ***HMS Holdings Corp - CFO***

Yes; let me add to that. In the first six months of this year, we implemented about 25% more new customer contracts than we did in the same period a year ago. So, that means, typically after implementation the revenue is generated in the next quarter or the following two quarters. So that's also a good sign. And an indication that we will meet those expectations.

Steven Valiquette - ***Bank of America Merril Lynch - Analyst***

Okay. Just one other quick question on the Louisiana. Obviously it speaks what's your services if they tried to go in-house and now they're coming back. Are there any extra comments to make there on maybe what didn't work out so well for them, and their attempt to bring it in-house? And why the coming back? It's well-[vetted] at the point, but just curious to get any extra color on that as well.

Bill Lucia - ***HMS Holdings Corp - President and CEO***

Well, I think in general, states are not well prepared, once most of these service has been outsourced, to be able to staff up and replicate the types of work that HMS does, particularly in identification of third parties. Because the massive national eligibility database we have cannot easily be replicated. And then, of course, the second part is, building the recovery activities to recover from those third parties. So I think that really forced the state to come to the conclusion that it made sense to, again, issue an RFP for these services. And the nice part, when it comes to Medicaid coordination of benefits, is Medicaid has a three-year lookback. So, if for some reason in the last 18 months they missed something, we are able to catch that in the three-year lookback that we are performing.

I think the other positive thing is, in the desire to control costs, is that Louisiana did just expand Medicaid -- rapidly enrolled 250,000 people under the expansion, with an expectation of another 125,000 will enroll. And with that need, I think they felt the need to establish better cost controls. So, all of that was a positive in driving the procurement and, of course, us being successful bidder.

Steven Valiquette - ***Bank of America Merril Lynch - Analyst***

Okay; thanks.

Operator

Dave Windley, Jefferies.

Dave Windley - ***Jefferies LLC - Analyst***

Hello, good morning. Thanks for taking the question.

So I wanted to follow-up on the commercial piece. And, understand seasonality, I guess I'll call it, if any. So I had thought about this as being a business that was in pretty significant ramp. You're growing it nicely, layering on new contract wins and implementations pretty regularly. And so I would have thought that this would be a little bit more of a sequential grower, and wanted to understand what elements -- whether it's activity, or seasonality, or volume of claims, or things like that, or perhaps even like you've talked about with Medicaid, where there's a lot of work initially when the members come on. And then that eases off behind that. Just understand why you'd have this dip down in the first half of the year and then ramp back up again in the second half after a strong second half last year?

Jeffrey Sherman - ***HMS Holdings Corp - CFO***

Yes Dave. This is Jeff.

I do think it's important to put the quarter in the proper context. The fourth quarter of last year was a record quarter for commercial health plan revenue. And did reflect the year-end push by some of our largest customers to generate revenue. We did talk in the first quarter of this year that there was around $3 million in special projects for health plan customers, which we didn't expect when we initially projected Q1 revenue. And the result was a 30% year-over-year increase, versus the first quarter of

2015. So, for example if that $3 million had fallen in the second quarter versus the first, revenue would have been approximately 23% higher in Q1 and 18% higher in the second quarter, so both quarters would have been more closer to the full-year 18% to 20% range.

So I would say, that said, PI revenue payment integrity revenue can be uneven from quarter to quarter. And our guidance is based on expected growth for the full year, which we do remain confident we will achieve.

Dave Windley - ***Jefferies LLC - Analyst***

Okay. So if I take your example on the first quarter and, say, take those special projects out, and think about a strong push in the fourth quarter dropping down to a lower level in the first quarter. Again, just trying to understand, in terms of the underlying activities that you are performing on those members, is there some kind of seasonality that dictates the revenue potential of a member being different later in the year than earlier in the year? Or is there something we should basically be keeping in mind that will then apply again to the first half of 2017?

Bill Lucia - ***HMS Holdings Corp - President and CEO***

No. I think, other than Q4, we do tend to have some of our larger customers ask us to do more work or maybe expanded scope of work, as they are pushing for their year end goals. I think, really we're just talking about the sales queue and how that flows through implementation. And that does still take time. So we've had strong sales growth, and as we have said in our prepared remarks, we are focused on reducing the time of contract signing to actually producing revenue. So it is actually just flowing through that process and working through the implementation queue. And we have added resources to do that. So I think other than that, it's just sometimes the payment integrity work, when we find problems and we fix our customers, patch their big holes, it makes our PI revenue a little more lumpy, so more difficult to predict on a quarter to quarter basis, which is really why we are trying to focus on overall expectations for the year.

Dave Windley - ***Jefferies LLC - Analyst***

Sure. Okay; thank you.

Operator

Mohan Naidu, Oppenheimer.

Bill Lucia - ***HMS Holdings Corp - President and CEO***

Mohan? Let's move on.

Operator

Stephen Lynch, Wells Fargo.

Stephen Lynch - ***Wells Fargo Securities - Analyst***

Hello, guys. Thanks for taking the questions.

With the strong performance of commercial health plan sales in the quarter, can you maybe just take the opportunity to remind us how the revenue per life compares on average between COB and payment integrity? And maybe as an add-on to that, now that we've crossed over the 100 million life mark, can you give us an update on where things stand in terms of percentage of the base that have adopted both COB and PI?

Bill Lucia - ***HMS Holdings Corp - President and CEO***

Those are good questions, Steven, and I hate to disappoint you. But the revenue per life from program integrity is extremely difficult to calculate with any kind of specificity because every project is different.

Let me just give you a couple of examples for color. The 15 million lives we just sold on commercial at risk in ASO is the first time we are working on that population. So it's a different result that will come out of that versus what happens in Medicare -- or Medicaid, really based on payment rules and provider contracts. We are, I believe, first [pass] behind the client on that work. But sometimes we are second or third pass. So when you're second or third pass you typically find less. Or you may find more, which means you could move up to the next pass. So it's very hard for us to be specific on the dollar per life that payment integrity is worth. And then it depends on whether we are doing clinical or data mining or automated versus complex reviews.

There are other metrics around COB versus PI. So in COB, the average Medicaid program, 10% of their lives have Medicaid or have other coverage. It's a little higher on the dual eligible population. But other than that it's really hard to compare the value per life. And I think we personally would need byproduct by line of business -- Medicare, Medicaid, or commercial -- a few more years to really gather that data.

Jeffrey Sherman - ***HMS Holdings Corp - CFO***

This is Jeff.

I would just add, from our customer base, our customers -- each contract is unique in terms of the scope of work, where we can do, what types of providers we can go after at any given time to do recovery work. And just the overall scope of audits. So I think we're trying to focus more on just our overall state revenue growth and our commercial health plan growth over time, knowing there's a lot of factors going into that. But I think at the higher level, we feel more comfortable, obviously, giving guidance at that level based upon all the puts and takes that occur over the course of the year.

Bill Lucia - ***HMS Holdings Corp - President and CEO***

In terms of the number of clients that we're upselling to -- that still is from small clients up to the largest. But I think what we said -- we continue to say -- is, the larger plans, the larger national or larger regional plans, continue to be more significant buyers of our services. And we believe that's because they are very sophisticated. They understand that it doesn't make sense to build more bricks and mortar to do this work when they can get a 10- to 15-to-1 return on investment from HMS. And just add on to an existing -- the integration's already done. The claims flow is already happening. So adding another project and getting a significant return is better for them. So I would continue to say that the large regional and national plans continue to buy more. And on an average, have a larger percentage of products upsold to them than the smallest plans.

Stephen Lynch - ***Wells Fargo Securities - Analyst***

That's great. And then, maybe also just one other one.

On the 15 million lives -- the existing client's decision to bring in this population of a- risk and ASO lives -- can you just talk about how the conversation progressed that ultimately led to that decision? Maybe details around timing? When did this happen in the lifecycle of the customer? Were you already in talks with them about the other populations that you do work for them on? And then, do you feel like that this is something -- the way this conversation flows -- is something that could be replicated among your other clients?

Bill Lucia - ***HMS Holdings Corp - President and CEO***

Let me start with the last question first. The answer is yes. We have talked long about our strategy to penetrate and radiate these plans. And they all started based on the Medicaid population, right? Our [parks] heritage in Medicaid give us the entree to the commercial plans that take Medicaid risk. But what happened over the years, and with this customer, who was not only grown organically, but grown through acquisition, is that we have proven strong results. And as they look at the results, in their Medicaid or Medicare lines of business where we've been doing work, we're always constantly talking to them about expansion and trying to propose additional services that will bring them dollars.

And so, as they look at that and they look at other challenges they may be having -- as you know, most of the commercial plans, other than a few, have said there have been significant challenges in their exchange population, which has impacted their commercial results. We, through strong delivery and strong results have been able to upsell these large organizations. They often happen at the time when we are renegotiating our contract, or we have introduced the new product or service that we're introducing; a specific type of audit. They are large complex organizations, so they don't happen overnight. They don't just drop in our lap. They do take a lot of time, as we are building the relationships.

The thing that I think we talked about a while back that is bearing fruit, is that we have structured our commercial organization based on the type of buyer. So, the large nationals have a sales team dedicated to them; an account management team dedicated to them, because they act similarly. The independent Blues have a sales team and the account management team dedicated to them, because they buy and act similarly. And the same thing on the regional plans. So I think that's really finally bearing fruit -- that we have customized the client, meeting their buying process and also supporting them in a similar manner. So because we've become more customized that way, this is more coming to fruition. But it does take a long time. It takes a long time of building the relationship, and having repeat significant return on investment, which we do for all our clients.

Jeffrey Sherman - ***HMS Holdings Corp - CFO***

This is Jeff.

I would just add, on the ASO market, as we talk about the long-term demographic trends and just overall medical costs and inflation in the ASO market, it represents very good opportunity for us. We believe as well, as costs continue to arise for employers and ultimately they're looking for help and solutions to help bend their cost [code], we think we can be part of that solution.

Stephen Lynch - ***Wells Fargo Securities - Analyst***

Thanks.

Operator

Ryan Daniels, William Blair.

Ryan Daniels - ***William Blair & Company - Analyst***

Yes; thank for taking the question. Congrats on the strong quarter.

Bill, maybe one for you just on the UPIC. I know that announcement wasn't made until late May, so pretty nascent. And nothing coming of it yet. But longer term, how should we think about that in regards to when you may have the opportunity to bid? What that addressable market is? And how might that consolidate existing Medicare and Medicaid business into a single offering in a region?

Bill Lucia - ***HMS Holdings Corp - President and CEO***

The UPIC is still separate from the RAC. They are separate programs. And at this point, no plans to combine them. The UPIC is a cost-plus contract, so that's really how you bid. Initially, vendors bid to be awarded -- its under what's called an IDIQ, indefinite delivery indefinite quantity. So it just means that the feds can, up to a certain amount, award work to the qualified vendors. I think it's $2.5 billion over the next 10 years. And it's both on specified procurements -- so task orders for regional UPICs and other projects deemed important by CMS or proposals they receive from vendors.

So, it's really important for us to get qualified under something like an IDIQ so that some of the work that CMS may want to have done that HMS is very highly qualified for, we can propose to CMS. We are cautious in that we are reminding everybody that it is a qualification. We are one of seven, and we will be bidding as appropriate for either UPIC task orders or other work. I think the important thing is the recognition from CMS that we have very strong qualifications in program integrity and that our typical competitors in the commercial side are not part of this procurement.

Ryan Daniels - ***William Blair & Company - Analyst***

Okay, perfect. Very helpful. And then maybe a follow-up for Jeff.

The margin performance -- obviously very good. I know you talked a little bit about that. But one notable area was the direct project costs. I think they were down well north of 200 basis points year over year. Anything in particular there with your scaling or operating costs? Or maybe some of the revenue recognition to consider as we model that line? And think about gross margins in general moving forward? Thanks.

Jeffrey Sherman - ***HMS Holdings Corp - CFO***

Yes, overall, as we look at the back half of the year, we're expecting total operating costs to be flat compared to the last half of last year. So we did have some higher cost related to some of our work in the Medicare RAC contract related to wages and medical chart pulls that we just don't have in our forecast right now, because the contract expired at July 31. So I'd say overall, we are continuing to see good cost performance and expect the back half of 2016 to be flat with the back half of 2015, even with a significant revenue jump up.

Ryan Daniels - ***William Blair & Company - Analyst***

Okay; thanks again.

Operator

Greg Bolan of Avondale Partners.

Greg Bolan - ***Avondale Partners - Analyst***

Hello, guys. Congrats for me as well on the strong results.

With regards to your bidding on the Medicare RAC program, what was your internal thought process around the decision to bid? And if you were to be awarded a region, could we expect flattish profitability similar to the old contracts?

Jeffrey Sherman - ***HMS Holdings Corp - CFO***

Well, I think, first of all, we had to take the prospect of the reduced ADR limits in volume as we looked at how we were going to approach the contract. It still had to be economically viable for us. And so we had to obviously reflect and reduce volume as we thought about our pricing in the contract. And so I think the total number of claims we'll be able to audit will still be in flex over time, because even with the reduced ADR limits, there was a provision that if providers had higher error rates, that we could audit more claims. So I think we took our best guess on what we thought the volume would be. And had to price the business appropriately.

In terms of comparing it to prior periods, I think that's going to be difficult until we have a clear runway of what is the total scope that we can do and where we see the volumes play out over time. As I mentioned in my prepared remarks, we were able to do a little bit more work in the second quarter on some accounts that were not subject to the ADR limits. So I think that could help over time. But I think ultimately we had to price the deal to make it economical based on the reduced scope and audits that we were seeing.

Greg Bolan - ***Avondale Partners - Analyst***

That's great, thanks.

And then, we've seen some disruption in the provider-led health plan momentum recently. If this idea peters out similar to a couple of decades ago, could this be a longer-term net positive for you? As those lives migrate to payers you potentially have better business relationships with?

Bill Lucia - ***HMS Holdings Corp - President and CEO***

That's possible. We still, from a strategic perspective, believe that we have to be and will be -- we do serve some provider-led health plans today. They're provider-owned. And some of the ones that nationally are probably well known are clients of ours. What we don't serve today, and we think as an opportunity in the future, are more the large risk-bearing providers that act like a health plan. So an MSO or large IPA could potentially be a client and require the same types of services. But it could be a net positive if the lives move back to just the large payers and they're not managed by the smaller provider-owned plans. I think, from our perspective, the same work needs to be done no matter who's taking the risk, so I don't know if it's a net positive or not.

Jeffrey Sherman - ***HMS Holdings Corp - CFO***

I would just add, our strategy is to be prepared to service the lives if they're in health plans or in other risk-bearing entities. To offer our services to meet those needs regardless of where the lives are.

Bill Lucia - ***HMS Holdings Corp - President and CEO***

And we think the other risk-bearing entities are less prepared to manage coordination of benefits on a Medicaid population, or less prepared to understand if a downstream provider has a propensity for fraud. We think that opportunity may be a positive one in the future. So we haven't really pursued it yet, but it's in our sights.

Greg Bolan - ***Avondale Partners - Analyst***

Okay; just trying to kind of think outside the box here. Thanks guys.

Operator

Charlie Strauzer, CJS Securities.

Charlie Strauzer - ***CJS Securities - Analyst***

Hello, guys. Most of my questions have been answered.

But looking at the new potential opportunity in the PI space for CMS there, can you perhaps frame market opportunity there a little bit better? Maybe give a little more color there? And also, are there other potential opportunities coming down the pipeline that you could talk about as well as similar to them? Thanks.

Bill Lucia - ***HMS Holdings Corp - President and CEO***

Well, Charlie, I think you are thinking more of what we just talked about the UPIC contract. I believe there will always be additional procurements coming out of the Federal Government, and most likely after the election. I think that, after there's a presidential election, no matter who comes in, there's always, within a year, some sweeping program integrity bill that gets passed. Because it's sort of like mom and apple pie: you can't fight the fact that we should have program integrity in our government-funded programs.

So we should expect to see a little bit of a pendulum swing back to the favor of making sure payments are accurate in those programs, particularly when you have Medicare trust fund projected to run out of money in 2028. But a little more color on the UPIC: it is a 10-year contract, so that is a long runway. And though it's primarily for the unified program integrity contractor task orders by region, it is also an ability for CMS to award work across the board through competitive bidding amongst the selected providers. So it's $2.5 billion over 10 years is the authorized spend. So we'll see what that opportunity is. But for us, it's a bidding license, so to speak. And not having to become qualified again in order to win business. And that's always one of CMS' s preferred methods to buy services, so that there is not as much protest and all of that process that can go on with the federal procurement.

Jeffrey Sherman - ***HMS Holdings Corp - CFO***

And then with the Medicare RAC contract, keep in mind, there was an administrative change that reduced the ADR limits from 2% to 0.5%. So that can be broadened in the future and actually expanded [on the lives] we can do in the future, if that change were to be made.

Charlie Strauzer - ***CJS Securities - Analyst***

And remind me -- CMS does not have to reprocure the contract to make that shift? They can just do that administratively, right?

Bill Lucia - ***HMS Holdings Corp - President and CEO***

That is correct. On the ADR limits, that is correct. They have changed it administratively in the past and could do so in the future.

Charlie Strauzer - ***CJS Securities - Analyst***

Excellent; thank you very much.

Operator

Matthew Gilmore, Robert Baird.

Matthew Gilmore - ***Robert W. Baird & Company, Inc. - Analyst***

Thanks for taking the question.

I just had one left, which was to get an update on the acquisition front. It seems like dialogue there has been pretty active. But Jeff, can you maybe just update us in terms of the current thinking on return special [for you]? Would you do a deal that would be dilutive in year one if it had great growth on the out year? Or would you still want to be accretive in year one? Any update on that front would be great. Thank you.

Bill Lucia - ***HMS Holdings Corp - President and CEO***

Yes, hello, Matt. Thanks for the question.

I think we're looking to make long-term strategic investments. And so I think, particularly if we are looking at some smaller companies that have very good technology but maybe not as large of a customer base, that we could see a potential first-year dilution. But nothing that I would consider to be material. So I think, the larger the transaction, I think we would look to have that be a shorter period of time, obviously. Bottom line for us, the pipeline continues to be very active, and I think really we've taken a proactive approach by identifying and pursuing opportunities before they reach the auction process. And that is paying dividends. It is hard to predict timing, but we do feel good about the activity we have, in that, over time we will be able to close acquisitions and really help complement our organic growth through inorganic growth.

Matthew Gilmore - ***Robert W. Baird & Company, Inc. - Analyst***

Got it. Thanks for taking the question -- appreciate it.

Operator

Robert Willoughby, Credit Suisse.

Tyler Harris - ***Credit Suisse - Analyst***

This is Tyler Harris in for Bob today.

Can you guys discussed some of the IT cost-cutting initiatives in the quarter? And maybe any further runway for progress you have going forward?

Bill Lucia - ***HMS Holdings Corp - President and CEO***

Yes, hello, Tyler.

The biggest thing impacting the quarter is, we did have some depreciation expense decline just for previous investments that have been amortized off in the quarter. In terms of our future capital deployment, IT investment and platform consolidation, as we talked about investing in data onboarding, and actually making investments to help us bring data on faster and quicker, is areas that we're looking at for IT investments. So, even though our CapEx this year has been below what we are expecting from a quarterly perspective, we guided to about $20 million in CapEx for the year. We do expect higher activity in the second half of the year. So I think we've got also initiatives to consolidate some of our IT platforms. Those are multi-year projects. But we think over time that will lead to cost savings and efficiencies and actually allow us to do our work more efficiently. So I would expect over the next four or five quarters we will continue to be making investments in our IT infrastructure. And that, we would expect, would pay dividends over multiple year periods

Tyler Harris - ***Credit Suisse - Analyst***

Great; thank you.

Operator

Frank Sparacino, First Analysis.

Frank Sparacino - ***First Analysis Securities - Analyst***

Just one for me.

I wanted to go back -- and maybe I missed this; I apologize if I did. On the 15 million new lives, did you discuss whether that was a number of different existing plans you were working with? Or was it all one large chunk from a single client?

Bill Lucia - ***HMS Holdings Corp - President and CEO***

Yes, it's one single client, and its at-risk and ASO lives.

Jeffrey Sherman - ***HMS Holdings Corp - CFO***

And it's a customer we are already doing Medicare and Medicaid work for.

Frank Sparacino - ***First Analysis Securities - Analyst***

Great. And then, just lastly for me -- Bill or Jeff, can you remind me where we are at in terms the yield improvement on the payment integrity side of things? I know COB was first and we're largely through that, but where do we stand today?

Bill Lucia - ***HMS Holdings Corp - President and CEO***

It's a key focus of ours in both product areas. And we have a lot of people working on yield improvement. So a couple of things impact that. I mentioned a few moments ago, investing in our IT capacity to actually bring data on faster and more accurately helps drive yield. So it's an area in the payment integrity side certainly. We still have more opportunity on the yield side, there. It's less mature in terms of our internal focus on the yield opportunity there. But we have teams of people focused on driving better and more results from our existing customers and our existing customer data.

And it really it involves a lot of processes. We have black belts in Six Sigma work being done to eliminate unnecessary or unproductive reviews for things that we are doing. So I think the combination of all those things, I think we still have a fair amount of opportunity in the payment integrity side. And its a challenge to discreetly break out, because if we are already doing business for the customer, it can be a challenge to discreetly break out on an individual line item basis. But we can look at long-term trends of customers and see yields improving. And that's really what we used as our yardstick for evaluating our performance there.

Operator

Mohan Naidu, Oppenheimer.

Mohan Naidu - ***Oppenheimer & Co. - Analyst***

Thanks for squeezing me back in. Congrats on a great quarter here.

Bill, just want to go back to the commercial book one more time. Are you guys actively engaging the employers around this ASO population? Or is that an opportunity that you can go in and try to influence the health plans to come in and take up more of these services?

Bill Lucia - ***HMS Holdings Corp - President and CEO***

We do talk to employers. But primarily what we serve employers with is their dependent eligibility audits. I would say, we think we are the most automated in that marketplace; have the most effective product line. And we have a very broad distribution there, both with benefit consulting firms and the direct sales team. While we talk to employers about their concerns about rising costs, in reality the best way to get at that rising cost is through the AFO plans, and serving the plans to better help the employers contain costs.

And so that's really our strategy. Now, whether a benefit consulting firm helps us with that dialogue at a health plan or does that and recommends HMS to a health plan because a very large employer of theirs is seeking better cost-containment strategies -- that maybe one way in which we pursue it. But for the most part, directly to the employer is not as effective. They don't always have access to the claims data; it's harder to get access to that data. So while we may help them audit their plan, make sure their plan summary, plan description is set up appropriately, to really get at that volume, it's much better to get at it through the large ASO plans, who are existing clients of ours for the most part.

Mohan Naidu - ***Oppenheimer & Co. - Analyst***

That's great. That's it for me. Thank you very much.

Operator

Thank you. At this time I'm showing no further questions. I'd like to turn the conference back over to Management for any closing remarks.

Bill Lucia - ***HMS Holdings Corp - President and CEO***

Want to thank our investors for their commitment to the Company; our employees who work passionately every day to improve the healthcare system; and our clients, who recognize the value of their partnership with HMS. We look forward to speaking with you again on our third-quarter call. Thank you.

Operator

Ladies and gentlemen, you may now disconnect. Everyone have a great day.