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# EDITED TRANSCRIPT

HMSY - HMS Holdings Corp at William Blair Growth Stock Conference

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## CORPORATE PARTICIPANTS

**Bill Lucia** *HMS Holdings Corp. - Chairman, President, and CEO*

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

## PRESENTATION

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

I'll go ahead and get started. We might be a minute or two early, but give us a little bit more time. Thanks for coming to the HMS Holdings presentation. For those of you whom I have not yet met, my name is Ryan Daniels. I'm the healthcare services and technology analyst here at William Blair who covers HMS for our organization. So my great pleasure to introduce our speaker today, Bill Lucia, who is the Company's Chairman and CEO to my left.

I won't go into a lot of detail on the story, as Bill will do that, both here and then during the breakout session, which will take place downstairs immediately following in the Bellevue Room. But just a couple quick highlights. Great organization; glad to have them back here at the Growth Stock Conference once again. It's probably nearly a decade they've been presenting.

And I think a really interesting time to be here, as the business model has evolved quite a bit over the last year or so alone. They have moved not only from the traditional fraud waste and abuse that we think of as third-party liability or Coordination of Benefits and program integrity with commercial insurers, but through some recent transactions moving into more care management, identification, and outreach to high-risk patients, etc.

So I think a great time to get an update, both on the core business and on some of the investments that the Company has made. And how that is extending the value proposition the organization can provide to their payer clients.

So with that, again, I'll turn it over to Bill. And just two quick reminders. Again, we will be down in the Bellevue Room, where we will walk down for the Q&A. And then second, I'm required to inform everyone that disclosures are available on our website at williamblair.com.

So with that, I will turn it over to Bill.

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**Bill Lucia** - *HMS Holdings Corp. - Chairman, President, and CEO*

Thank you, Ryan, and good afternoon, everybody. I hope I'm not keeping you from your lunch during the lunch hour. These are our obligatory disclaimers.

And I thought I'd just talk to what we'll be talking about today. I will give a brief overview of our business, our market opportunity, the top-line growth, expectations, our opportunities for expansion in margin. I will introduce our latest acquisition, some of the strategic priorities for the Company. We will talk a little bit about what might or might not happen with Medicaid, and then we'll conclude on really why HMS exists.

So in terms of our business, our entire Company is really focused on bending the healthcare cost curve. And as everybody in this room knows, whether you are a healthcare expert or not, the healthcare system growth is somewhat out of control, a significant portion of our GDP, and there isn't a silver bullet to solve the problem. And if there was, it would've already passed both houses of Congress and we would've had a different healthcare system.

So -- but traditionally, the Company has been focused on really removing errors from the system. And there's about $180 billion a year in payment errors in our healthcare system. Our heritage product or our really first product in the payer space, originally targeted for state Medicaid agencies,

but now serving at least 90% of the Medicaid health plans in the nation, is Coordination of Benefits. And that's really where Medicaid is the payer of last resort, and where there's a third party that should pay, they should pay first. Low income working population does have coverage -- access to other coverage.

This product line has very high barriers to entry because of the data we've built over the years. And it's still-- well, with our recent acquisitions, it's probably about 65% of our annual revenues.

The other area that is a little less mature for us, but is just the natural extension of having amassed millions of millions -- I'd say billions -- of claims, and then being able to mine through those claims to look for problems is what we call Payment Integrity. And that really was the -- not what's the claim paid by the right party, but was the claim actually paid appropriately.

And of course, all of this is done under a very overarching ability to ingest millions and millions of transactions from our clients, apply sophisticated analytics, and then achieve ROIs for our customers of 10 to 15 to 1, which is a pretty good ROI and a pretty remarkable one in our industry.

And then lastly is the new area that Ryan had touched on that we are both building and buying in and that is care management and member engagement technologies. And that's to really get at the 5% of the people in the US who are 50% of our costs, so the very chronically ill members. And we'll talk a little bit more about that.

So like any company, we strive to leverage our key assets. And really our key assets are really a very large and diverse national customer base. So today, we have over 300 health plans with clients, about 42 states, and the federal government and a couple agencies within the federal government.

And so with that, we have a significant population of claims that we can provide analytics on. And unlike a number of our competitors, because we are national in scope and we serve all of the programs in healthcare, we are able to look at the propensity of a provider for upcoding or overcharging or creating an error and then apply that analytics across our entire customer base.

So I think having that data, having this proprietary logic that we've built over the years, particularly in the Coordination of Benefits area, and then a distribution system that enables us to sell into each one of these very critical markets. So we are what we believe is the go-to company for cost containment for any entity that's taking risk, even providers that take risk.

The Company did start, as I mentioned, in the Medicaid space. And that has been a calling card, particularly for the Medicaid managed care plans. Because we work so closely with Medicaid agencies, we often know before a plan does what a Medicaid agency is going to focus on. That's very critical to us.

And having a grounding in government has been critical, primarily because, whether we like it or not, HHS is still going to be driving a lot of changes in the healthcare industry over the years. And being close to them and state governments where a lot of the innovation will happen is pretty critical. So we are proud to have a government as our heritage, but with the commercial business or our commercial line of business health plans being our fastest-growing area.

We have very broad expertise across the industry, but one of the things that's very important to us is being HITRUST-certified. HITRUST is the gold standard for healthcare security. The Company's been certified now for over two years. We get recertified -- in fact, we were just recertified recently, and our security officer sits on their Board.

So it's a very important rubberstamp. In fact, there are health plans who have said to vendors: if you are not HITRUST-certified by a certain date, you'll no longer be able to work with us. So we think that that will help us with a little bit of consolidation of vendors in the market.

Of course, we have own and/or have access through our network of 800 credentialed physicians and nurses to review any clinical determinations that need to be reviewed. And we have a pretty large IT shop and that's because we constantly apply technology against our product lines to both improve the yield per unit, and of course, reduce the cost per unit of our services.

This is a little bit of an eye chart, but it just tells you about the volume we are dealing with as a Company. We now serve 10 of the top 10 or all of the top 10 health plans in the nation. We used to serve 8. We got one additional one through the Eliza acquisition, and then we sold one of the largest top 10 plans to get all top 10 in the first quarter this year on our Coordination of Benefits business.

We deal with significant volumes of transactions. So we are probably little known in terms of that, but 39 billion claims in our systems, and that's just in our active database.

We have over 90% of the claims data for the Medicaid population in the nation. And we are just starting to use that data in different ways to start to look at a Medicaid member as they move from plan to plan. And so that's an interesting new area on this kind of new third leg of the stool for the Company.

And as I talked about, a significant customer base. We interact with almost 1 million providers a year. So while we are typically auditing providers, we do serve providers who take risk. But since we are auditing, it's very important that we have great and high-level interactions with healthcare providers.

So let's talk a little bit about the market opportunity. As I said before, we used to really focus on errors, right, and there's $180 billion a year paid in error. That is a staggering number alone, and quite a total addressable market if you think that we recover or save a couple billion dollars a year for our clients. So it's still the tip of the iceberg.

But when we took a step back and looked at all of the data that we have and where the real problems in the healthcare system are, it's estimated that true waste in the system -- overutilization, underutilization, people not getting the services they need, not adhering to their medication, the chronically ill members having a disproportionate amount of our spend -- that we are up to $1 trillion, which is almost a third of the spend of healthcare in the nation.

We said that really should be our addressable market. So as a Company, that $1 trillion of waste in the system is where we're really focused. And this third building block of looking for the highest-risk, most chronic members, making sure we have a platform to manage them through or our clients do, technology platform, and then engaging them so they can take the appropriate actions.

So for us, it's an extremely large market with an actual market size probably of in excess of $10 billion. So we have a long way to go as a Company to reach that.

So we'll talk a little bit about what we are doing as a Company to really grow. And part of it is really just leveraging the historic business that we have, COB, which in our first quarter grew year over year 7%.

It's a very sticky business. Medicaid members move on and off of Medicaid and they move on and off of employment. And anytime that happens, and it happens at a frequency of about every six months, so sometimes shorter, sometimes longer, there's an actual transaction for us that is a revenue event.

So that's almost a annuity that continues to grow. And that won't change until there are some fundamental change in the Medicaid program, if there is one in the new repeal and replace.

And then of course, adding our program integrity services to those Medicaid Coordination of Benefit clients has been our focus the last couple years. And now our new focus is to sell this new vertical into the customer base. And we think there's a great opportunity to do so in those plans between 100,000 lives and 1 million, where HMS has 90% penetration of them as customers.

We have been for a couple years and will continue to invest in Six Sigma Black Belts and then technology tools that are driving down costs or maintaining our costs and driving up the efficiency or the yield per unit. This year, we are implementing a new Big Data infrastructure that's allowing us to ingest data faster.

But we are also introducing robotic process automation and machine learning to automate some of the manual tasks that are done as a Company. And again, reduce our costs, which will from our perspective grow our margins and improve our yields.

And then we are developing products, but when we're looking at introducing new products into the market, it's a build-or-buy question for us. And speed to market is important. So you'll see us in a combination of both introducing products built from HMS and actually acquisitions.

And as we've said before, our first use of capital is to pursue acquisitions. We are a little picky from that perspective. We don't want to overpay and we want to make sure that it's accretive within the 12 to 18 months. And the beauty of buying a service that we don't own today is that we have this very large customer base to sell and rapidly engage our sales team in to sell this new product line.

So let's talk a little bit about just the macro environment behind our growth. One of the biggest areas for growth that's pushing the entire healthcare system but clearly Medicare is that it's expected -- enrollment is expected to grow 12% by 2020.

So 10,000 people a day are enrolling in Medicare. They are becoming Medicare eligible, and that is the baby boomer population, which I think I am part of, but I'm not ready to enroll in Medicare.

But with 10,000 people a day -- and we all grew up for the most part in health plans, right? It could have been fee-for-service, but a lot of us have been exposed to managed care and HMOs. So most of them are picking -- the new enrollees are picking Medicare Advantage plans. And that's very positive for our commercial marketplace.

Of course, as we've all read, the nation is struggling with an older population with more high-cost chronic conditions and comorbidities, both mental and physical health. And as I said before, a key message that you'll hear from us for a long time is 5% of the nation costs 50% of our costs.

And so if we can address that, if we can get at that 5% and just start turning down that dial, we can have a real impact. So we are mission-driven to bring that cost down. And while there's no silver bullet, we are one of the only companies, we believe, in the marketplace that really has been successful in driving down costs throughout the healthcare system.

Another driver, of course, is employer-sponsored insurance. While we work for employers today, primarily doing dependent-eligibility audits, we believe the new Eliza platform and member engagement has application there. And employers are going to go and to continue to be the dominant source of coverage in the US for the foreseeable future, so we think that's a growth opportunity for us as a Company.

One of the other drivers is as a -- we are a self-insured employer administered by a health plan. But what's happening now is the larger employers are telling their health plan administrators or their TPAs: great, you bring me great network discounts and you usually pay claims accurately, but I need more savings. So we think that speaks well for both them buying Payment Integrity services on something that they weren't typically at risk.

So the insurance company really had no skin in the game, the employer did. So we are starting to see what's called ASO or administrative services only insurers, buying services -- and TPAs. We are also -- we believe that push from employers will drive more our member engagement solutions.

And then as we know, there are potentially going to be fewer dollars for government programs. We say that -- we've never seen that happen, but whatever the repeal and replace is going to be, it may have controls on the growth of Medicaid. It's clearly going to have to incorporate some features to make sure that the Medicare trust fund stays solvent.

And anytime there's cost pressure from the federal government down to the states, there is a need for more cost-containment services. And anytime there's a cost pressure from the states, they are pushing it down to their health plans. So the whole system when there's cost pressure is usually a strong benefit for HMS.

In terms of margin expansion, I touched a little bit about this. We do have a scalable business model. Our core infrastructure is in place. Relatively low CapEx, though we've increased it this year for the technology tools that I talked about, which we believe will have significant impact on margin and operating leverage.

Our incremental revenue does typically come in with higher margins than the Company's average. And we expect to see that in the new businesses that we acquired, particularly because we believe we can rapidly grow them across our customer base.

Six Sigma, we've been doing this for a couple years now, and we do have a number of Black Belt engineers that really run across the Company on very focused efforts to drive down costs and bring up that yield per unit.

And as I mentioned, this year, we have a big project on both data ingestion into our Hadoop data management system so we can access data faster. But we are also implementing robotic process automation, which we believe can help reduce the number of steps people have to take to do their work. And also machine learning, which can along with this RPA really start to automate more of the functions we do today. Again, it's a way to not increase our costs as our revenue line goes up.

So this year is a big focus on technology. And we are spending about 8 -- we typically spend on an average $29 a year in CapEx. This year, we are spending $28 million, so a step up, but for technology that we think will have a significant return on investment.

So let's talk about our recent acquisition Eliza and a little bit about why we did it. And I'll take a step back. When we did our strategy refresh about two years ago, we looked at what any good company should do. What are your assets that you can redeploy?

And for us it was data. It was data and a large customer base. And when you have such insight into a health plan or provider taking risks and the data about their members, you want to take that data and make it actionable. So again, the 5% costing the nation 50%, you got a move the needle. And the way to move the needle is to apply advanced analytics to understand the highest risk members that you may not know about yet, so there's some predictive nature to this.

Has HMS seen that member before but you haven't? If we have, we can tell you on day one this is the risk level that you're going to deal with. Our clients tell them it takes them four to six months to figure that out.

If I can tell you on day one you can have an impact in your margins but you can also have an impact on outcomes, and of course other things that are important to health plans, like HEDIS and Star Ratings.

So we built that product ourselves; started to introduce that into the market. It's in an alpha test in one large Medicaid state and three of their health plans are also alpha testing the product. But we then said we need to have a system that actually that transaction can be tracked through; that member's care can be tracked through.

And health plans use it. Some of our plans use four -- I've seen a nurse use four screens to manage a patient, a high-risk patient. So we bought the Essette system, which is a care management suite that now is cloud-enabled and allows a payer or a provider at risk really to manage -- it's really a traffic comp for all of the care management activities that you can track.

It's got built-in automated workflow that mirrors clinical pathways. It's integrated with provider portals, EMRs. It's a very open system. But it's really the system to track are you taking care of these high-risk members and what are the processes that are being done. Anything from scheduling to appeals and grievances, all that is tracked in the system.

So it's typically sold first as a case management system and then clients buy up other modules. So that's the traffic cop to take that high-risk member, make sure you're tracking the activity on behalf of them.

And then Eliza is really the engagement engine. Eliza is the engine that allows us to reach out and engage that member to take specific action or behavior. Eliza's competitors really started as outsource call centers, whereas Eliza said no, we are going at this with a technology perspective.

And they started using IVR, interactive voice response. And then ultimately built their service out to include SMS text, email, and of course, a live agent if one is needed.

But in reality, they patented the technology using behavioral sciences, some advertising know-how, and then claims data analysis to be able to determine the best modality about reach to a member. So in reality, you may sign up for something and say that email is your preferred method, but we know that what you really respond to is text. And that's actually what's baked into this patented set of algorithms.

I'm going to talk a little bit about a case study because I think it is applicable here about Eliza and why it fits under this cost-containment umbrella. So we had a health plan that needed engagement activity. They had significant gaps in care that was impacting their HEDIS rating.

Of course, it's a managed Medicaid, so the membership is transient. They are on and off on an average of six to nine months at a plan; limited time to have an impact. They had multiple programs to raise their HEDIS scores or Star Ratings that are going to be competing for resources. And they didn't know the best way to outreach to a patient.

So what Eliza did was, of course, we came in with the sophisticated analytics that basically say taking all this history and some third-party consumer data, how are we going to have an impact on your population. And reality what happened was they had a member engagement rate in the teens. So we basically doubled the engagement of their members.

That's pretty important because if you can double the engagement, that means you're not going -- you're not going to get double the impact, but you're going to get a lot more members who are willing to then take the next step that has to happen.

They closed almost 13,000 gaps in care, which helped them improve the 10 other HEDIS measures. And HEDIS measures are very important for your ratings from a Medicare Advantage or a Medicaid managed care plan and also how you get paid from the government.

And then there are some other statistics on this chart. But the kinds of things that using HEDIS methodologies, they were improving -- improved their cervical cancer screening rates by 13%. These are the kinds of things that prevent people from getting into a chronic illness state.

And basically what the plan did in this very short period of time, because we ran this through our model in really just a couple months, they were able to improve their revenue by over $15 million. So that's a significant impact to a Medicaid plan in a short period of time.

What that tells us is that Eliza has the kind of impact on health plans from the revenue and potential cost savings perspective as HMS does in its other cost-containment businesses.

So we are really talking about knowing the members, engaging them, and then doing a better job for payers so that payers can do a better job of managing these health outcomes. So what we've been doing in this new leg on the stool is layering in these tools.

So giving them some intelligence in terms of the population, but not just what is broadly called population health management, but what we like to call really about chronically ill member management. So drilling down to -- if you want to find the people in your state or your health plan that filled four opioid prescriptions from four different doctors last month, we can give you that information and then you can take action.

Now that one might not be a member engagement action; that may be a provider engagement action. You may need to lock them into a specific provider. But we can drill down at a level where our clients in the past said we got a lot of data analytics from pop health companies, but we didn't get actionable member-level analytics.

So again, for us, it's giving you alerts on the key people in your health plan or in your state plan that are the most chronically ill or that are going to become the most chronically ill, engage them, and then track all of that engagement in this real-time interdisciplinary hub.

And then of course, long term, if you think about this, it's integrating all the other Internet of Things: the wearables and everything else that can be integrated into the care management platform.

So let me talk a little bit about what our strategic lens looks like. In a broad brush, we are really looking to continue to leverage our key assets. So we have this very large customer base. We have probably the largest database of information about healthcare eligibility in the nation. All of us in this room are in that database, and 90% of the Medicaid claims data in the nation.

So as Medicaid gets squeezed, HMS is going to be one of those places that both the federal government, the states, and the managed care plans are going to come for results.

With us aggregating that data across, we can see areas of fraud in the provider base. And then of course, areas where we can more rapidly impact care on the member base. So implementing our ability to move through Big Data more rapidly is critical. It's expected to improve our revenue per unit and also cut down our costs, improve service delivery to our clients.

All of the tools that we are implementing are not homegrown; they are all COTS or off-the-shelf technology, so they are very easy for us to get support to implement it. Then of course, we bring our secret sauce to the table and our customized algorithms to that data.

We half been focused extremely heavily on streamlining business processes, as I said, and developing new products that are driven by what our customers need. So we spent a lot of time reaching out to our customers on a very proactive basis.

Every year we do a customer survey, a satisfaction survey, and our Net Promoter scores are extremely high. They are in the 40s, and for a services company, it's usually low teens on an average. So that's something we strive to continue to improve.

And then of course, we believe we prudently deploy capital, but our first use of capital is, as I said, M&A. And then of course, we'd look at -- we are looking at CapEx improvements or addition of CapEx this year for technology.

But we are also really focused on share buybacks as appropriate from an opportunistic basis. And we had an authorization of $75 million. We spent about $70 million of that on an average share price of below $13 a share. So again, we were opportunistic and that was a positive.

So in terms of cross-selling, the biggest cross-selling initiative we have now is to take all of these clients -- and particularly this midmarket customer base, where again we have 90% of the Medicaid managed care plans between 100,000 lives and 1 million who are less sophisticated; they don't have the infrastructure of the large nationals -- and to sell them on our Essette care management and Eliza member engagement solutions.

And we think that's where we'll be able to accelerate the revenue growth rather quickly. Because they just don't have the capacity to compete for the behavioral scientists and the advertising people and all the people you need to put together to build the appropriate type of care management and engagement solution.

As we've talked about before, we have a new member analytics product. It does look a little like this. I know that's an eye chart, but really it's configurable by client. So if a client tells us I want to know my COPD members with the highest cost, I want to know my diabetics that have been noncompliant, not taking medication. Whatever those big buckets are that they want to know day one instead of waiting for six months later, this is what's delivered. And then they can drive and click down on that.

And then the goal is, of course, for them to export that member into the Essette care management suite so it's tracked. And then to use this tool to export into Eliza to be able to do member management campaigns. So that's really how that whole wheel fits together in our view.

We will continue to look at acquisitions. The areas and the acquisitions that we are focused on are in Payment Integrity, where we think there are rollups of companies that may be doing audits or algorithms or edits a little different than ours.

And of course, further building out our care management solutions for chronically ill members. And we think both of those, there's a robust pipeline that we continue to work through.

But as I say often, we do kiss a lot of frogs and we are very specific. We are not looking for companies that we have to fix; we are looking for companies we can bolt-on and sell quickly to our strong client base. So we have the balance sheet to do so and we'll continue to do that.

Let me just touch finally on just the potential Medicaid changes in Congress. We're still a believer that rolling back Medicaid expansion and throwing 15-million-plus people into the uninsured base is unlikely.

Now, everybody can have their political view on that and whether it will happen or not. But we believe that the House bill is dead on arrival in the Senate and that there's going to be some negotiation about the Medicaid program.

It may some point mean that Medicaid's expansion will shrink in 2020, that would be the earliest. Now we are hearing maybe 2022. But the federal government, and particularly the new administration, has said to the states, look, we'll be very creative about solutions and covering your uninsured. So we're very pumped about that.

And also just the cost pressure that's going to come from any repeal and replace will ultimately drive down cost pressure throughout the system and drive up services for HMS.

And I'm going to go quickly through this because I'm out of time. But I think this is really why we are here. We really create a true partnership with our clients to solve their problems and to reduce the cost curve that's happening in the nation.

And again, this $1 trillion that is spent in one way shape or form in error needs to be controlled. And we are one of the few solutions now with our third leg on the stool that has a holistic approach to do so.

Thank you for your time.

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

We'll be down in the Bellevue Room in a few minutes. Thank you.

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