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HMSY - Q1 2017 HMS Holdings Corp Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the HMS First Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference over to Dennis Oakes, HMS Investor Relations. Please begin.

Dennis Oakes - *HMS Holdings Corp. - SVP of IR*

Thank you, Latoya, and thank you, everyone, for joining the HMS earnings conference call for the first quarter of 2017.

Joining me this morning are Bill Lucia, our Chief Executive Officer and Chairman; and our Chief Financial Officer, Jeff Sherman.

Earlier today, we distributed our first quarter 2017 earnings release through our website at hms.com, under the Investor Relations tab. We also posted an investor slide 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 via the Events and Presentations tab on our website, and a replay of the call will be posted later this morning.

Some of the information we will discuss on this call will consist of forward-looking statements, including without limitation those related to revenue, operating cash flow, operating margin and our future business outlook and expectations. Such statements are based on the company's current expectations, and actual events may differ materially from those expectations.

Likewise, the financial statements in today's earnings release reflect preliminary results, which are not final until our Form 10-K from 2016 and first quarter 10-Q are filed. We refer you to the company's filings with the SEC for a description of important risk factors that could cause actual results to differ materially from those indicated 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, May 10, 2017. Further, the company disclaims any intent or obligation to update any forward-looking statements as a result of developments occurring after today's call, except as required by law.

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

(Operator Instructions)

We're now ready to begin. Bill?

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

Thank you, Dennis, and good morning, everyone. Our first quarter financial performance was below expectations, but we are addressing the issues that caused the lower-than-anticipated year-over-year quarterly revenue and remain confident in the growth trajectory of our business. We also view the acquisition of Eliza Corporation as a substantial boost to our growth profile in both the short and longer term as it significantly enhances the capabilities of the new third vertical we initiated with the purchase of the Essette care management platform, last year. The commercial health plan revenue miss in the first quarter relates primarily to execution of internal plans to speed up the implementation of Payment Integrity business sold last year. We reorganized the entire Payment Integrity function in the fourth quarter, which now reports directly to Doug Williams and have since added resources consistent with our view of the sustainable growth opportunity in PI. The executive management team is focused on completing a variety of process improvements we believe will position us to reach our original full year financial targets, without including the incremental and very positive impact of the Eliza acquisition.

With the balance of my time this morning, I want to provide context for what we see is a strategically valuable asset in Eliza and explain its health engagement management business in the broad context of improving health outcomes and reducing medical costs.

We are very enthusiastic about the financial profile of the new health management and member engagement solutions we can now offer on the Essette and Eliza platforms. We believe we can roughly double in revenue by 2020 on the 2016 base, approaching $60 million. And similar to our historic product suite, the new vertical will have healthy margins and strong cash flow.

Let me begin with the description of Eliza. It is a cloud-based technology platform, which provides comprehensive and personalized health engagement solutions designed to improve clinical outcomes and reduce costs by motivating members to adopt targeted behaviors. Eliza has developed sophisticated communication techniques based on proprietary and patented predictive analytics, behavioral science and digital design methods created to effectively engage members and achieve preferred health outcomes. Their solution suite targets gaps in care and provides tools to pursue appropriate condition management, raise quality scores, improve cost savings and generate increases in wellness, medication adherence and member retention. We anticipate that the Eliza predictive analytics and technology will also be applicable across our existing product suite, which is an added benefit of the acquisition.

Eliza offers a best-in-class solution for entities taking risk. Their end-to-end engagement platform includes sophisticated population analytics and integrates proprietary data, a deep understanding of the health care consumer and multichannel outreach technology to deliver superior results. Their data assets include nearly 100 million unique lives and unmet consumer insights, which are utilized to identify channel receptivity and the propensity of members to take action. Eliza also provides a tailored experience at scale, which is coordinated across all aspects of the member experience throughout the plan year. Payers generally have several criteria for selecting third parties to engage their members. Specifically, they want flexible solutions to meet their unique needs; a company with a track record of success and a meaningful ROI; one that provides an affordable alternative to handling health engagement management in-house; the ability to integrate their own data across varied interventions; the capacity for multichannel outreach in order to reduce the number of vendors needed; a true strategic partner who can produce actionable insights into their member population and the latest technology solutions. In short, knowledgeable purchasers want what Eliza provides: industry-leading member engagement, which is innovative and constantly evolving as markets and customer needs change.

Our 2 recent acquisitions have also significantly expanded the total addressable market for HMS services, opening a path to attack a broader swath of health-care waste estimated to be as high as $1 trillion annually. We believe our new suite of health management and member engagement solutions offers a substantial cross-sell opportunity with our existing customer base, particularly as payers seek to improve the health outcomes for the small percentage of their population that account for the majority of health care spending. Another factor expanding our market reach with the Eliza acquisition is their medication adherence work for pharmacy benefit managers, including one of the top national PBMs, which is a new revenue source for HMS. In addition to the growth opportunity, we were attracted to the Eliza revenue model, which has benefited from the industry trend toward program-based contractual recurring revenue. Another very compelling feature and competitive advantage, which Eliza brings to HMS, is the sophistication of their outreach. They have invested heavily in the development of analytics to prioritize which members should be targeted for specific interventions based on individual health profiles. Eliza also derives a deep understanding of member behavior by integrating claims, prescription and lab information with self-reported data. Adding HMS claims data will further strengthen the Eliza offering, allowing us to approach existing customers whose data is already loaded and immediately demonstrate how targeted populations can be identified and engaged.

Though this is a new business line for us, we view the health management and member engagement solutions we can now offer as a natural extension of the cost-containment activity, which has formed the core of our business for 25 years. We can leverage our extensive data assets and expansive customer base while addressing 3 imperatives we have heard repeatedly from customers in recent years. They want to work efficiently and effectively to control health care expenditures beyond just the savings resulted from negotiated network discounts and tighter plan design. They want to consolidate vendors, and they are intently focused on attracting and retaining consumers.

Specifically, health plans have told us they are reducing vendors and seeking bundled solutions that integrate actionable analytics and outreach capabilities. Eliza has a reputation for innovation, effective integration and a track record of outperformance compared to industry benchmarks. They're also viewed as a flexible partner capable of tailoring solutions to meet customer needs. Their client base includes over 55 health plans as well as other risk-bearing entities and PBMs. The combined HMS and Eliza customer relationships now include all of the top 10 national health plans and 23 of the top 25. We added 2 of those top 10 with the Eliza acquisition and added another by directly signing one of the large independent [blues] in the first quarter. Health plans typically interact with their members across at least 5 major categories: enrollment and onboarding; care management and utilization review; quality initiatives, such as HEDIS; member services; and pharmacy management. The member engagement model is continually evolving. Health plans historically took more of a short-term transactional approach to these member interactions often to address a pressing need, such as closing gaps in care before star-rating deadlines. Payers are now more taking a longer-term view. That means moving toward a more comprehensive Eliza-type model, which includes analytics and engagement and utilizes multiple communications channels to reach plan participants. We believe HMS is now well positioned to thrive in the health management and member engagement field. We can do so by taking full advantage of the industry-leading solutions we acquired in Essette and Eliza, which are enhanced by the ability to leverage our pre-acquisition data assets, analytics expertise and large customer base. We are confident in our ability to grow this new area of focus, which presents the opportunity to broaden existing customer relationships and make our cost-containment solutions even more attractive to potential new customers.

I'll now turn the call over to Jeff to provide his thoughts on the quarter and an update on our full year outlook to reflect Eliza. Jeff?

Jeffrey S. Sherman - *HMS Holdings Corp. - CFO, EVP and Treasurer*

Thank you, Bill, and good morning, everyone. Turning to our first quarter financial performance. The lower-than-expected year-over-year growth in our commercial health plan revenue is certainly not what we expected, but I think some context and perspective is helpful.

We did forecast the usual quarterly revenue decline from the fourth quarter to the first quarter of $8 million to $10 million. The actual reduction, however, was about $5 million above the midpoint of that range. Because the amount is less than 1% of projected full year total company revenue, we currently expect to be able to make it up as the year progresses.

On the plus side, Coordination of Benefits revenue in the quarter was up 7% year-over-year and State revenue increased in the mid-single-digit range we expected, up 5% compared to the first quarter of 2016. The challenge rests squarely with our Payment Integrity revenue, which actually declined $2.6 million year-over-year. We don't lack commercial health plan customers for our Payment Integrity products nor do we lack PI sales, which were robust in 2016. We simply have not converted those sales to revenue at the pace we expected and know we are capable of, nor have we seen the full anticipated benefits of the Lean Six Sigma focus last year on our PI processes. We've spoken in the past about the complexity of implementing Payment Integrity products, and those challenges will always be in front of us.

That is why we're making incremental investments in big data solutions, software, hardware and personnel that are designed specifically to increase capacity and speed up the process. Another factor which is consuming implementation resources is an increasing number of re-implementations of existing accounts. This is generally the result of customers switching to new IT systems and often relates to COB business. The process is virtually identical to new installation, but we are simply preserving existing revenue. The bottom line is, we have made progress in the time it takes to complete implementations and to develop and implement new PI edits, and we've also increased throughput, but there is more work to do.

We have specific action plans in place to improve our PI execution, which we currently believe will get us back on plan so our full year objectives are met.

We expect the cadence in terms of total quarterly revenue, excluding the $35 million from Eliza, will reflect sequential increases of roughly 10% in each of the 3 remaining quarters of the year on top of the first quarter base of $114.5 million.

Prorated for the mid-April start, we anticipate Eliza revenue will step up modestly each quarter throughout the balance of 2017. We had no Medicare RAC revenue in the first quarter and expect little or none in the second quarter. At best, we now anticipate 2017 RAC revenue will be at the bottom of our projected $6 million to $10 million range. We do expect to begin receiving claims stated this quarter, and CMS has told the 3 RAC contractors that any audit scenarios approved for one will be deemed approved for all, which should speed up that aspect of the process. We have received no indication to date, however, of any intent to modify the parameters of the program, including any increase in the 0.5% ADR limit, though the administration has made public comments about more aggressively pursuing health care fraud, waste and abuse.

Before turning to the balance of 2017, I want to touch briefly on what might appear to be an unusually low effective tax rate in the quarter of about 4%. The rate was driven primarily by a few discrete items totaling a net of approximately $300,000.

Otherwise, our effective tax rate in the quarter would have been close to the projected 37% mark, which we continue to expect will be the effective rate for the full year.

With regard to the impact of the Eliza acquisition on our expected full year financial performance, we continue to anticipate reaching the original targets for total company organic revenue, margin improvement and operating cash flow we articulated in February prior to the Eliza acquisition. The $35 million we expect in 2017 Eliza revenue is incremental to that view, producing total company year-over-year revenue growth of approximately 15%, assuming the midpoint of our previously guided range of 7% to 9%. We currently expect most -- all of the added Eliza revenue this year will be the result of sales to commercial customers, which we will define more broadly going forward to include health plans, disease management and home health companies, provide our own plans and PBMs, all of which are included in the existing Eliza customer base. We do believe the new health management and member engagement solutions will also be attractive to our state government customers over time, but do not anticipate meaningful revenue this year. As a result, our view of mid-single-digit growth in our State customer base is unchanged by the acquisition. The Eliza margin profile is similar to our core business, and we are not contemplating any economic synergies, so there's also no change to our projected full year margin improvement of 125 to 150 basis points.

I do want to point out that SG&A in the first quarter included professional fees in connection with the acquisition and audit of our 10-K, which totaled about $1.5 million or the equivalent of approximately $0.02 in adjusted EPS. Looking ahead to the next quarter, we currently expect to have additional fees tied to the acquisition, which closed in April and the ongoing audit totaling about $3.5 million. Those expenses were not contemplated in our year-over-year margin guidance. We currently expect the acquisition to add approximately $3 million to $5 million to operating cash flow, so no meaningful change to our full year estimate of $90 million to $110 million. That view takes into account the seasonally lower cash flow we experienced in the first quarter, which was consistent with our expectation and reflective of the payment of cash bonuses and estimated taxes at the beginning of each year.

Finally, Eliza presently operates at scale, so we anticipate very little short-term capital investment, and therefore, have an unchanged view of full year capital expenditures of approximately $28 million.

CapEx in the first quarter was approximately $8.5 million, which primarily reflects investments in our big data infrastructure.

As a reminder, our first quarter numbers are preliminary numbers, which won't be final until our auditors complete their work and we file both our 2016 Form 10-K and first quarter Form 10-Q. Since our Form 10-Q cannot be filed until after our Form 10-K is filed, we intend to take the time afforded by the automatic extension provided by the SEC to file the Form 10-Q.

While we currently do not expect any significant changes to the previously reported results, we need to complete the last open items on the annual audit to be certain there is no change. The testing has been very complicated and labor-intensive, but we believe we are close to completing the audit.

Bill will now share our current view of the events in the nation's capital relating to the Affordable Care Act, and then we'll be ready for questions. Bill?

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

Thank you, Jeff. The postelection debate about repeal and replacement of the ACA has been a rollercoaster ride for many health care companies, including HMS, and the ultimate outcome still remains unclear.

With a narrow victory on the House floor last week, there is considerable question about how the measure might need to be altered to garner the votes necessary for passage in the Senate. The fact that the debate on this highly politicized issue has dragged on this long is really no surprise given the complexity of our health care system, the partisan divide in Washington, along with the burdensome legislative process. Based on everything we know as of today, let me briefly reiterate our current thinking.

We believe a massive rollback in Medicaid eligibility is unlikely. Any change in funding for the current expansion criteria and resulting federal reimbursement will probably be delayed until 2020. Some states may put in place new plans for their Medicaid population in the meantime, pursuant to the new administration's preference for state-based innovative solutions. And the attractiveness of the cost-containment services we offer could actually be heightened if federal reimbursement to state is ultimately capped in some fashion as proposed in the House bill.

Before closing, I want to reiterate what we said following the Essette acquisition. We now see the addition of Eliza, which significantly builds out our third vertical of health management and member engagement as a natural extension of the product suite we have offered historically, an opportunity to further leverage our greatest assets and a strategically focused response to the need for payers to improve member health outcomes and reduce their costs. This new business fits neatly under the cost-containment framework of our COB and Payment Integrity solutions and strengthens our credentials as a market leader.

We are proud to say that HMS is one of only a handful of companies, who are truly able to provide the tools, which at-risk entities need to help them bend the health care cost curve.

Latoya, we are now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Jamie Stockton the Wells Fargo.

Nathan Weissman - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

This is actually Nathan in for Jamie. I guess for the first one, are the issues ramping the new programs integrity contracts that you're not getting the data feeds you need through enough? Or is there something else slowing implementations?

Jeffrey S. Sherman - *HMS Holdings Corp. - CFO, EVP and Treasurer*

This is Jeff. I'll start. So first, we said in my prepared remarks, we have seen an increase in the number of reimplementations that we're doing, which is primarily more on the COB side of our business. So that has consumed some resources that would have been primarily focused on implementing new sales. I think in terms of the larger question about our ability to convert PI sales to revenue, we weren't as quick as we expected in converting PI sales to revenue in the first quarter, and we're working hard to ensure we're back on track. There are going to continue to be challenges with the complexity of PI implementations, but we believe we have the necessary action plans in place. So as Bill noted in his prepared remarks, we've centralized all the Payment Integrity activity under Doug Williams' leadership. You saw our capital investments in the quarter ramped up significantly. So we're making significant investments in big data -- particularly in big data investments, which we think is going to improve both our analytics capability and our ability to integrate data quickly. We've also increased our Payment Integrity resources from the fourth quarter to the first quarter. We've added about 4% more Payment Integrity staff in anticipation of ramping up new work. We've also accelerated our edit development work in terms of the number of edits we're developing to drive more PI's revenue, and we've focused dedicated IT resources to help drive that as well. So I think all of those actions, which have been ongoing for the last couple of months, we believe, will help get our Payment Integrity revenue back on plan.

Nathan Weissman - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Okay, great. And then I guess for a second one, expense growth was pretty significant in Q1. Obviously, we will see Eliza expenses feather in starting in Q2. But can you talk about the cadence of how core expenses should change the rest of the year?

Jeffrey S. Sherman - *HMS Holdings Corp. - CFO, EVP and Treasurer*

Yes, I think, as you look at our overall operating expense line, if you look that through '16, it's in a pretty consistent range. And obviously, in the first quarter, with little bit lower revenue than we expected, you don't see much flexing on the cost side. So I would expect, as we see revenue ramping up throughout the year, you'll see some incremental costs to service that revenue. But we will get some leverage as the revenue grows, and we'll expect to see a margin improvement as a result of that.

Operator

The next question is from Mohan Naidu of Oppenheimer.

Mohan A. Naidu - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Jeff, on the implementations, I guess, is there any risk to the current contracts or any contractor goals or deadlines because of these delays in implementations?

Jeffrey S. Sherman - *HMS Holdings Corp. - CFO, EVP and Treasurer*

I think we've always said it can take anywhere from 6 to 9 months or longer on the Payment Integrity contracts to get those implemented. So that's part of the process. But I also want to emphasize, when we say implementation, it isn't just for new contracts that have been sold, it's the whole process of once we've sold the contract and we actually get it to revenue generation. So some of this implementation work is just still focusing on previously contracts that had been sold and the data process has been done. But we still have the work to do to get edits in and all the process of actually generating revenue from sending out claims and having findings, et cetera. So it is a more complicated process. And we've always said, it can be lumpy as we find errors that are corrected by our customers over time. We had this constant process of having to continually develop new edit. That's why I think the work we've done and with some, I would say, specific action teams focused on this, we think it's going to drive better results as the year progresses.

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

And, Mohan, let me give you a little color on this. This is Bill. One of the things about the new at-risk commercial market or even the ISO market that we discovered along the way wasn't in the implementation plan with the client, but discovered along the way was, as we develop new edits, the actual overpayment plan, overpayment recovery plan, has to be improved by the large -- approved by the large employer. So let's say they have a 20,000-member group or 40,000-member group, as a client, that client has to approve the strategy that we're going to take. We didn't really know that going into it. Not saying we shouldn't have, but it was not in -- wasn't in the contract or MSA or Statement of Work. So the new commercial risk business takes a little longer, because you're bringing up major employer by major employer on the ASO side.

Mohan A. Naidu - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

So I guess for the rest of the year, you still need quite a bit of ramp-up in the commercial business. How much visibility do you have right now with these approvals and stuff beyond, the things that are beyond your control to get that revenue that you need to meet the full year guidance?

Jeffrey S. Sherman - *HMS Holdings Corp. - CFO, EVP and Treasurer*

I think we have decent visibility in terms of what's been sold. We have an implementation queue. At times, that implementation queue can get changed or reorganized based upon changes in customers' demands or requests. But I think we have good visibility on that. But obviously, again, there's several factors that are going to drive that. It's the implementation work we've talked about. It's improving yield. So we still have dedicated teams focusing on yield both for COB and Payment Integrity. So we always continue to see yield lift, which will drive the commercial revenue as well. And the added work that we talked about for Payment Integrity will drive more commercial revenue as well. So all those are factors, which will factor into that commercial revenue growth as the year progresses.

Mohan A. Naidu - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Okay, maybe one last question around the Medicaid expansions. Is there still optimism for some of these holdout states to push for the expansion before maybe a potential ACA repeal?

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

Well, I mean, we believe there's still going to be states that are going to approach the new administration, states that have already talked about filing 1115 waivers or some other sort of approach. The Secretary and the new administrator have reached out to Medicaid directors and said they will be very flexible in their approach. So we have states like Maine and Virginia and a couple of others that -- North Carolina, that have signaled they'd consider expanding, but they want to have specific requirements in. You've heard and seen in the bill about work requirements or seeking to work requirements. So we believe the new administration is going to be very flexible about innovative solutions that are going to help states manage their Medicaid programs in their own way. And they have committed to being quick in their approval of appropriate waivers. So I wouldn't discount the fact that there probably would be some states that have the opportunity to expand, and there still is, of course, enhanced federal funding for that expansion population.

Operator

The next question is from Nicholas Jansen from Raymond James.

Nicholas Michael Jansen - *Raymond James & Associates, Inc., Research Division - Analyst*

Just wanted to dig a little bit deeper into kind of the second quarter or the implied kind of sequential ramp that you talked about, that 10% improvement that you've quantified as 2Q excluding Eliza. Is that what your experience is witnessing already? And in April, just to try to get a sense, is the implementation backlog already starting to come to fruition? Or do you hope that you have a stronger May or June as we think about that Q1 unwinding?

Jeffrey S. Sherman - *HMS Holdings Corp. - CFO, EVP and Treasurer*

Well, I would say our revenue did accelerate throughout the first quarter on a sequential basis. And we would expect that trend to continue in the second quarter. We don't -- we haven't spoken about kind of monthly performance at all in the past. But we certainly think based upon the plans we have in place, what's in our implementation queue and the additional work we're doing on both Payment Integrity and COB that we can get there. I do want to make another point just on commercial revenue growth, we still have commercial revenue growth opportunities in COB as well, so I don't -- we don't -- it isn't just Payment Integrity. I mean, COB still makes the majority of our commercial health plan revenue, and we still have a lot of yield initiatives on driving more revenue in the COB side as well. And the big data investments we're making we've already seen have an impact on our COB yield just by getting data in better and using data more effectively. When you think about the amount of data we ingest every month, doing it quicker, better and having better view on what the opportunities are will drive COB commercial health plan revenue growth as well.

Nicholas Michael Jansen - *Raymond James & Associates, Inc., Research Division - Analyst*

That's helpful. And my follow-up would be on the margin. I think you reiterated 125 to 150 basis points operating margin improvement relative to the 2016 baseline. And I think that doesn't include the close to $5 million of first half of the year costs tied to the 10-K audit and the Eliza transaction fees. So just wanted to confirm that, that improvement is on an apples-to-apples basis excluding that. So as we think about our 2Q model for margins, we should bake in an incremental headwind tied to that expense because of the apples-to-apples dynamic.

Jeffrey S. Sherman - *HMS Holdings Corp. - CFO, EVP and Treasurer*

That is correct.

Operator

The next question is from Ryan Daniels of William Blair.

Ryan Scott Daniels - *William Blair & Company L.L.C., Research Division - Partner and Healthcare Analyst*

I wanted to dig in a little bit more to the reimplementation work. I don't think that's an issue that you've talked about in the past and maybe that does not mean that it hasn't surfaced. But I'm curious on a couple of fronts: why you're seeing this wave of new IT systems at the insurers, if there's anything specifically driving that, and thus, your reimplementation work? And the number two, I'm curious what kind of visibility you have on that, meaning could we be surprised 2, 3, 4 months from now that a couple of major clients do this reimplementation, and it causes another workload for you? Or do they give you pretty good visibility on that such that you're comfortable with the rest of '17?

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

So this is Bill, Ryan. Thanks. A fair amount of the work is on the state government's side where the state has changed their -- what's called their MMIS vendor, and the MMIS vendor needs to program new extracts for HMS data claims provider and member data. There are times when those implementations on the MMIS side are delayed, and they cause us issues. I mean, that's just happened in the past. And it's been noise, but it's never been anything significant. States try to make sure that the old systems are running in the meantime. But -- and often, states have data warehouses where the extracts come out of. But a lot of this is on the state side. There are conversions that happen and reimplementations on the commercial health plan side. They're not as frequent. Some are driven by us if the data quality from the client is poor or if the client has moved a line of business. So an example would be a large national, who has 14 claim systems, is consolidating down to 10 or 4. Whatever that process is, when they consolidate, we really just -- we've already mapped all of those systems, so it's just taking the plans that they've now put on to their target system and remapping them. It's a reimplementation, because once you've seen one claim file, you've seen one claim file in what is supposed to be a standardized health care system. But that's really it. It's not -- I think we have a reasonable volume of reimplementations, but we do have them every year, and I don't think we have a significant increase other than as MMIS systems change. And they typically change, I don't know, 8 to 10 years per client. They don't -- they're usually very long contracts.

Jeffrey S. Sherman - *HMS Holdings Corp. - CFO, EVP and Treasurer*

And Ryan, this is Jeff. I would just add, we have spoken in the past about realigning the implementation teams to have dedicated teams focused on implementations and reimplementations. So we've just seen -- we have seen it trend up with more reimplementations and so from a resource standpoint, as we look at the ability to push through new sales faster, it's just a factor that's taken place. So obviously, we have to look at our resources to adjust accordingly to that to drive faster revenue acceleration.

Ryan Scott Daniels - *William Blair & Company L.L.C., Research Division - Partner and Healthcare Analyst*

That's very helpful. And then going back to the Medicaid expansion and the potential 115 (sic) [1115] waivers, et cetera, can you talk a little bit about what opportunities that also could provide to you? I think you do some modest work in work requirement aspects of Medicaid, things of that nature. So is there potential that these waivers open up totally new state government opportunities for you as well?

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

Well, it's possible. I mean, we do some -- we consider eligibility-related work. Of course, we're working with states to focus on bringing any of that work in early in the process, and of course, also talking to the federal government about that, right? Because people would be -- there are a number of people who gain their eligibility through going through healthcare.gov through the federal exchange at this point. So there is always potential for additional opportunity when it comes to eligibility-related services. We don't necessarily do outreach to members today to ask them whether they're working or not, but clearly we have a very sophisticated outreach program that we've recently acquired and could do that if that was an opportunity.

Operator

The next question is from Robert Willoughby of Crédit Suisse.

Robert Mcewen Willoughby - *Crédit Suisse AG, Research Division - MD and Senior Research Analyst*

Bill, can you make any effort to maybe quantify the total opportunity, the cross-sell opportunity you do see with Eliza in your current book of business? How big could that be? And then secondarily, is it safe to say you've got your hands full with some of this new business activity and integration activity that cash you generate going forward would be more for deleveraging or some other purpose that maybe the capacity to do deals here is limited near term?

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

Well, let me start with the Eliza. When we started our due diligence or completed our due diligence, we basically kind of did the typical Venn diagram and said where do we have overlapping customers and where do we have new opportunity. And as soon as we announced the deal, but before it was closed, we already had inbound calls. So there is a lot of interest particularly because plans do not have the sophisticated analytics. I mean, we've had plans tell us that they've reached out to the same member 100 times a year. That's, A, not effective; B, by the first -- by probably about the fifth call, they're not going to even be bothered with you. Outreach doesn't even have to be a call. So while we haven't publicly sized the opportunity, we have a team working from the sales integration perspective already packaging the outreach to our existing customers. A number of them use Eliza, some in a international perspective, some not as broadly as others, and then we think there's a significant opportunity in what we call the regional players. HMS has a very, very large penetration rising out of our Medicaid COB in what we call regional plans. So these aren't your large nationals, but these are the ones who are less sophisticated, can't afford to have behavioral sciences inside the shop and don't have the analytics engines to decide how to engage members appropriately. Those plans are really looking for the more robust Eliza-like experience -- they don't want to pay for a transaction. They truly want to get to the 5% of their members who are costing them 50% of their spend. And we think there's a great opportunity there, and we have a significant sales effort going on to introduce them to Eliza. The second piece I'll add before I hand it over to Jeff to talk about M&A is that there is an opportunity to link our existing analytics, Eliza analytics and the Essette care management platform. So once we have identified through Eliza those members that need additional care or through the Essette care management platform, have identified members that need outreach, those 2 are a seemless link, and we're building that seamless link now. Jeff, you want to talk about M&A?

Jeffrey S. Sherman - *HMS Holdings Corp. - CFO, EVP and Treasurer*

Yes, and I would just add, Bob, before I talk about the M&A side. I mean, we obviously did research on the market opportunity before we acquired Eliza, and there's ranges of it. It's a several billion dollar opportunity in total addressable market for member engagement and growing, we think, roughly 8% -- the market growing at roughly 8% a year. So starting with the total addressable market, we're excited about the prospect. And then obviously, we believe Eliza is very well positioned as a market leader to continue to grow on that. And then as you look at our customer base we have and the combined customer bases and then 2 of the top 10 customers that we -- 2 of the top 10 national health plans that we didn't have as a customer, obviously, those foots in the door are, we believe, very helpful for the cross-selling opportunities. So I think we're excited about that. In terms of the M&A side, obviously, we're focused on integrating Eliza and have people helping us do that and are excited about the growth prospects there. In terms of M&A, we're continuing to look at deal opportunities. You can't stop doing that if you're interested in acquiring companies. So we still have sufficient liquidity to do that. We did use our revolver as we talked about in our release to acquire Eliza, but we're still modestly levered, and we'll continue to look at using our balance sheet to grow through strategic acquisitions, and there is still a lot of activity out there. So if there's acquisitions that can supplement a care management and member engagement portfolio we just put together with these acquisitions, we'll certainly look at those. We'll also continue to look at acquisitions on the Payment Integrity side and how -- if there's companies that have technologies or products that can help us accelerate or go into new lines of Payment Integrity as well. And there's probably more in the Payment Integrity side than the COB side, but we are continuing our M&A activities, and we'll be opportunistic, as we have been, with the Essette and Eliza acquisition in terms of the right opportunity.

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

And Dennis, I think you said we have one follow-up. So let me use my follow-up here. Bob, the other thing I wanted to mention was just this whole focus in the industry on consumer-driven health care. So clearly, in Medicaid and Medicare, you are focused on the consumer, right? You're not -- there isn't an intermediary like an employer. With the large block of business that we have that's Medicaid and Medicare, the Eliza suite of services applies directly to getting that consumer to do the things you need them to do. But we've even heard from the large nationals, and we've started to see the drumbeat that while employers are an important distributor, payer of health benefits, getting to the consumer is critical and retaining and -- attracting and retaining that consumer is critical. So we are -- we think Eliza establishes us well for what is continuing to be a wave of consumer-driven health care and all the facets that Eliza can offer us through that process.

Operator

The next question is from Steven Valiquette of Bank of America.

Steven J. James Valiquette - *BofA Merrill Lynch, Research Division - MD*

So you guys touched on some of this a little bit, but just curious in relation to the onboarding of commercial clients a little bit slower, how does this shape up externally from a client expectation perspective? Is this a situation where the clients are also expecting things to happen faster or maybe there's frustration on their end? Or is this -- or they're more indifferent and this simply has more to do with your own internal expeditions for the timing of commercial client onboarding relative to what you've communicated to the investment community?

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

Well, I would say it's a little bit of both. Clearly, if a client -- and, look, this is part of our sales story. I mean, get us the data, because you're going into queue, right, and we want you to be bumped high in the queue. But if you can't give us your data timely, we're not going to be able to implement you before the next account. So it's a little bit of both. Some of it -- look, some of it we've learned along the way, particularly as I mentioned earlier on the ASO business. But in reality, we are typically waiting for their action, and their action is often either data or approvals of the audits that we've developed. And then there's times where they are waiting for us to complete our implementation work, and that can be a dissatisfier for our customer, and of course, that's what our sales and account management team is doing -- is making sure that, that dissatisfier doesn't become a negative for us in the marketplace. But I can tell you that our sales funnel, our implementation queue continued to still be stronger than ever. So that to us is a positive that we have wind in our sales. And you'll see, as Jeff said, some of the expenses that we're incurring now are additional implementation, project management, people, data analytics and the data infrastructure and technology to make these things happen faster. So I would say just in summary, it's a little bit of both. It's probably a little more disappointing to us than it is to our customers, because they're used to lengthy delays in PI implementations, and they have their own IT system issues to deal with.

Operator

The next question is from Matthew Gillmor of Robert Baird.

Matthew Dale Gillmor - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Just had a couple of quick follow-ups. For the commercial revenue, Jeff had mentioned the need to develop additional edits as one of the issues, and I guess I was trying to understand that issue a little bit better. Is that due to the fact that once you all find an error that the pair can go back and over time correct their internal processes? Or was that some other issue like the need for the client to simply approve the edits?

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

Well, it's actually both. I mean, I think I've called this sort of like the arms race, right? So you do have clients who eventually fix their systems, sometimes very quickly, other times -- and this is more in our what I would consider our data analytics and mine -- data mining, where we're finding payment errors versus billing anomalies. Billing anomalies, which are DRG upcoding, where they're using the inappropriate DRG, those are much harder for the client to find and fix on their own. But -- so part of it is that the clients are coming behind us and trying to figure out how can we fix this in our payment system. Some are better than others at that. The other is just for us to be competitive to continue to be building that war chest of edits. And we have centralized edit development under one executive under Doug. That individual has all of the resources in the company that perform that work as well as any subcontractors we may use that have a specialty. And then, of course, that's also an area where we are looking to, as Jeff said, in the M&A side, to look for specialty PI vendors who bring a unique approach to data mining on a specific type of claim. So it is a little bit of a rollercoaster with PI. But in reality, there are still more errors than -- out there than can ever be fixed at any given point in time. So we'll never run out of runway is, I guess, what I should say.

Jeffrey S. Sherman - *HMS Holdings Corp. - CFO, EVP and Treasurer*

Yes. And I would say, we have historically focused more on institutional hospital claims, but there's also outpatient activity and physician professional side as well. So we think the universe is pretty large, and we also think some of the technology investments that we are making can help in a more automated way do some of this work. So we think there's leverage expansion capabilities in Payment Integrity over time by our technology investments also.

Matthew Dale Gillmor - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay, that's really helpful. And then just one on the Medicaid expansion discussion. I think Bill had mentioned Maine, Virginia and North Carolina as potential states that could expand. Could you just remind us which one of those states are important customers for HMS wide? I think North Carolina may be one, but just trying to get a sense for which one would be more impactful if they did expand?

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

Well, they all are clients. I think the largest impact to us just because of population size and the opportunity between the current eligibility rules and new ones would be North Carolina. North Carolina also has a waiver that I don't know if it's submitted yet to migrate to managed care, but right now, it's 100% fee-for-service population, large customer with a large broad array of services that we provide. Now those states -- I wouldn't take those as gospel, because those change all the time. There -- something new could come up next week that we don't know a state is talking to the administration about. We just know that the administration has reached out to the Medicaid directors and said we'll be flexible in approach as you submit waivers, and we'll approve them timely. So we think that's a positive message. But the states that would have the biggest impact across the board if they expanded, and I'm not saying that they are expanding, but the ones that would have the biggest impact are Texas, Tennessee, Florida and North Carolina out of the non-expansion states.

Operator

And the last question comes from Frank Sparacino of First Analysis.

Frank Sparacino - *First Analysis Securities Corporation, Research Division - SVP*

Jeff, probably for you, just on Eliza. Can you help us just understand kind of the progression throughout the year the ramp of the $35 million? And then also how much of a deferred revenue haircut is in those numbers this year as we think about that number sort of normalizing next year?

Jeffrey S. Sherman - *HMS Holdings Corp. - CFO, EVP and Treasurer*

When we made the acquisition, we said it was roughly about $50 million in revenue, Frank. So that's basically just a -- the $35 million just basically says from when we acquired it going forward. It's just an approximation of that. I would say it's probably reasonable to assume a similar acceleration as we discussed for the overall company revenue for Eliza as the year progresses. So roughly 10% a quarter on a sequential basis.

Operator

And at this time, I'd like to turn the call back over to Bill Lucia for closing remarks.

William C. Lucia - *HMS Holdings Corp. - Chairman of the Board, CEO and President*

Well, we want to thank you all for your continued interest in HMS. We look forward to speaking with you on our Q2 conference call. Thanks, and have a great day.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. You may now disconnect. Good day.