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HMSY - Q4 2016 HMS Holdings Corp Earnings Call

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PRESENTATION

Operator

Good day ladies and gentlemen. And welcome to HMS Q4 and full-year 2016 earnings conference call.

(Operator Instructions)

As a reminder, today's conference is being recorded. I'll will now like to introduce your host for this conference call Mr. Dennis Oakes.

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

Thank you for joining the HMS fourth-quarter and full-year 2016 earnings conference call. Joining me this morning are Bill Lucia, our Chairman and Chief Executive Officer and Jeff Sherman our Chief Financial Officer.

Earlier today we distributed our fourth quarter and FY16 earnings release to our website HMS.com under the Investor Relations tab. We also posted an investor slide presentation containing supplement 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 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, to those related to revenue operating income operating margin 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, our financial results in today's earnings release reflect preliminary unaudited results, which are not final until our form 10-K is filed. We refer you to the Company's past filings with the SEC, including our annual report on form 10-K. And our quarterly reports from form 10-Q for 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, February 24, 2017. And 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 on our earnings release and investor presentation, do 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 queue in a timely fashion.

We are ready to begin. Bill?

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

Thank you, Dennis. Good morning everyone and thank you for joining our call. As we look back on the year just concluded, we are very pleased with our overall financial performance.

Looking ahead to 2017 and beyond, we are excited and confident about the significant opportunities in front of us. 2016 was a year of solid growth in total revenue operating income and adjusted EPS. Adjusted EBITA also increased.

Overall profitability and margins improved, and operating cash flow remains strong. In addition, we achieved a key strategic objective for the year by acquiring a care management platform in the third quarter.

Total Company revenue last year was a record $496 million. Fourth-quarter commercial health plan revenue of $64.3 million was the second quarterly record in a row. And 23% higher than the average of the preceding eight quarters. So a very strong finish to the year, but not quite enough growth in the quarter to achieve our full-year target.

We do see the Essette Care Management and Care Coordination platform as the foundation for a third major vertical. In addition to our coordination of benefits and Payment Integrity products. It was designed and built from the ground up to serve as a care traffic controller, helping risk bearing entities identify, engage, and manage their at risk populations.

Essette is currently a web-based tool, but will soon be available as a full cloud and SAS offering. Along with our existing on premise model. We plan a modest level of capital investment this year to scale the business. Have already made our first post acquisition sales and have expressions of interest from several existing HMS customers.

We also intend to internally develop or acquire additional products and services in this new area of focus. We do recognize there are a number of large and well-funded players attempting to enter or expand their turf in the population health arena, which many view as a crowded field.

What we are pursuing, in order to meet customer demand for more cost savings solutions, is very different from most of those efforts for two reasons. First, this work is in natural extension of the products suite we have offered historically.

And secondly, we intend to take full advantage of the vast HMS database, our proven proprietary algorithms, and analytics capabilities to focus primarily on high utilizers, not broad populations. So focusing in on the highest risk members. Now, macro forces have generally created a tailwind for our business in recent years. And 2017 should be no exception.

Employer-sponsored plans remain the largest source of health insurance covering about half of the nation and their dependents. Employers are demanding more from their health plans, including greater cost-containment and better health outcomes. Not just the traditional network discounts and paying of claims. With less than 5% of our health plan revenue last year, from product sales covering at risk and administrative services only or ASO customers, we see this potential block of business as a substantial growth opportunity.

Medicare enrollment and spending are expected to grow significantly over the balance of this decade as baby boomers continue to age into their late 60s and retire. We are significantly underpenetrated with our health plan customers compared to the work we do for their Medicaid populations, so see significant upside opportunity to expand our Medicare Advantage presence over the next few years.

Studies of healthcare spending consistently show a steep upward trajectory over the next decade. With the CMS Office of the Actuary projecting growth at an average annual rate of 5.6% and representing almost 20% of gross domestic product by 2025. Within that spend the top 5% of the population account for roughly 50% of healthcare expenditures. Not surprisingly, the aging US population has a concentration of individuals with high-cost chronic conditions.

Often accompanied by multiple behavioral and medical comorbidities and expenses for the elderly and disabled are among the highest. Appropriately managing the health of high utilizers is critical to any effort to bend the healthcare cost curve. And our new vertical helps to do just that.

While an estimated 36 million individuals were enrolled in provider-sponsored health plans last year, providers generally lack experience with many of the complexities of managing capitated risk. Additionally, most provider-owned plans have some level of contracted care such as tertiary, outpatient rehab, or specialty physician services. As a result, they should want to take advantage of the same type of cost-containment and care management activities that other payers do.

As more providers take on Medicare and Medicaid risk, we view this as a growth area for HMS. In the shift to value-based payments for medical care is another area of potential interest. Though the pace of change in the long-term viability of these reimbursement methodologies is still unclear, we are currently working on a small pilot projects with payers so we're ready if and when these reimbursement changes gain traction.

In short an aging population, growing numbers of individuals with chronic illness, employers focused on reducing their healthcare expenditures, providers taking on health plan risk, and changing payment methodologies are generally acting as wind in our sales. The most significant headwind we face, which we see as more perceived than real, is the much talked about repeal and replace of the Affordable Care Act or ACA.

To be sure, the ongoing focus in Washington DC on potential changes to the ACA has raised concerns among investors because of our exposure to the Medicaid program. Though a broad range of outcomes is still possible, we believe there is presently more likelihood that the collective action of Congress and the Trump administration will be relatively positive for our business, rather than negative. That view is based on time I personally spent on Capitol Hill earlier this month, public comments by the Republican leadership and President Trump about preserving coverage input we received almost daily from our network in Washington and across the industry.

It is also important to note that estimates suggest up to 45% of individuals newly enrolled in Medicaid following enactment of the ACA would have qualified for coverage under the pre-ACA income criteria, further mitigating any downside risk of potential congressional actions affecting the expansion population. It may be several months before congressional action crystallizes, but there do not presently appear to be any proposals to eliminate insurance coverage for individuals currently in Medicaid, which could garner majority support in the House and Senate, including for those we became eligible pursuant to ACA expansion.

Other factors in play include opposition to any steps that would cause currently covered individuals to lose their health insurance by a number of key stakeholders including the American Hospital Association, the American Medical Association, and AARP. Additionally, Republican governors who took advantage of expansion have been clear that they want to keep it. And some observers suggest that Republican governors who resisted expansion might be granted more generous sectional 1115 waivers than those permitted by the Obama administration, actually resulting in Medicaid expansion beyond the current 31 states.

If federal reimbursement to the states for Medicaid were to move away from the current funding mechanism, and be replaced by block grants or a per capita reimbursement, we believe states would be even more focused on preserving the dollars they receive. Interestingly, their economics incentive could also be heightened by the fact monies recovered by states today must be returned to the federal government in the same proportion as the percentage reimbursement they received for their Medicaid expenditures. New reimbursement models may allow states to keep 100% of what they recover.

In my meetings with members of Congress, both Republicans and Democrats, I make the point that the existing Medicaid infrastructure is a well tested mechanism for enrolling individuals and administering health insurance benefits. I urged them to think about utilizing Medicaid as they attempt to find a replacement for the troubled healthcare exchanges, which by the way, and just as a reminder, we have no exposure to.

Though I doubt many in Congress have considered this approach, there seemed to be receptivity to the idea we could potentially utilize the Medicaid railroad tracks and technology infrastructure that are already built to address the challenges of the individual market. Finally, there appears to be a growing realization that designing and implementing any replacement for the current system could take many months, pushing the effective date of potential changes out as much is two years.

In addition to a macro healthcare environment, which is generally very favorable for our traditional products, and our expanding set of cost-containment solutions. Strong 2016 commercial sales activity strengthens our conviction that we can reach our 2017 growth targets. We added 17 million new commercial health plan lives this last year. Including a sale in the second quarter to a single customer for $15 million of their at risk and ASO members. We also sold additional products to existing customers covering approximately 30 million of their members during 2016.

That is compared to about 13 million in the prior-year. On top of the increased volume of health plan sales last year, the largest national plans continue to be biggest buyers of our products. At year end, they purchased about three times as many as the average health plan plus the balance of our customer base. The product mix of new sales during 2016 was roughly 75% Payment Integrity and 25% coordination of benefits. We expect to continue selling PI solutions disproportionately in the year ahead. As we are relatively underpenetrated compared to COB.

As we have discussed on a number of occasions, closing new sales is only one of the many steps needed for revenue generation. Efficient implementation of sold business is critical. And continues to be an ongoing focus of our process improvement initiatives, particularly for the implementation of Payment Integrity business which is significantly more complex than COB.

We made substantial progress last year, with a number of completed implementations increasing by nearly 25% compared to the prior-year and we expect progress to continue in 2017. Jeff will now add his perspective on the quarter and provide the details of our 2017 guidance. Jeff?

Jeff Sherman - *HMS Holdings Corporation - CFO*

Thank you Bill. And good morning. I want to touch briefly on a few key indicators of our strong 2016 financial performance. Full-year operating income increased over 20%. And full-year adjusted earnings were up 30% to $0.75 per diluted share. Our 1231 balance sheet was stronger than when we began 2016, even after the third-quarter acquisition, and $20.5 million in share repurchases during the fourth quarter. That strengthening was a result of another solid year of operating cash flow approaching $90 million.

Year end cash of $176 million gives us plenty of dry powder to make needed investments in our growth and consider additional acquisitions and share repurchases during 2017. As a reminder, these are not final numbers until our audit is complete. And there are still a few open items before we can file our form 10-K. In particular, we are working with our auditor to test our CMS reserve liability over the life of the contract which was 2009 to 2016. As a result, it may require adjustments to any final numbers.

This testing is very complicated and labor intensive. We are hoping to complete all open items by next Wednesday in time to file our form 10-K timely. If not, we might need to time accorded by the automatic extension provided by the SEC in these sorts of situations.

Turning now to the year ahead, we are projecting full year annual revenue growth of 7% to 9%, based on the following components.

High teens commercial health plan growth and mid single digits state government growth, which will be partially offset by declining Medicare rack revenue of $6 million to $10 million compared to $19 million last year under the old contract and lower federal, excluding Medicare RAC, and other revenue of approximately $20 million compared to $23 million in 2016. We expect full-year operating cash flow of $90 million to $110 million and full year capital expenditures of approximately $28 million.

The increasing CapEx compared to approximately $21 million last year, will go towards implementation of big data solutions directly benefiting both revenue and margins, ongoing upgrades to our data security, and IT infrastructure and incremental investment in the Essette platform.

Finally, we expect full-year operating margin improvement of between 125 and 120 basis points on a 2016 base of 11.6% and an annual effective tax rate of approximately 37%. Given the leveragability of our operating model we expect margins can continue to improve meaningfully over the next few years. Each of the numbers above are for the full-year and may not flow evenly throughout. A good example is first-quarter revenue, which we expect will decline on the order of $8 million to $10 million from the fourth-quarter level.

In addition, we are expecting a very slow ramp for the new Medicare RAC program, which like remains little or no revenue until the second half of this year. Achieving our health plan growth target is critical to achieving our overall objectives for 2017. So I want to briefly review the expected components of commercial growth for the year ahead. To begin with, we have the full-year benefit of new business implemented throughout 2016. Which we estimate equates to around run rate in excess of $60 million per quarter. Next is business sold during 2016 and scheduled for implementation out the coming year.

We expect again, to both shorten the time from ink to green and to increase the total number of implementations completed, resulting in earlier revenue generation. A fourth component of growth will be new sales. We expect to close in the first half of 2017. Such sales could be for totally new lives, but will more likely be related to sales of new products or the expanded application of currently sold products to a broader population for an existing customer.

In order to contribute to current year revenue, sales will generally have to be closed over the next 2 to 3 months. We expect product yield improvements across all of our business to again contribute meaningfully to expand net revenues and higher margins in 2017.

Two other items that possibly impact revenue growth. Though both are outside of our control. First, we benefit by organic enrollment growth experienced by our customers across their employer and government lines of business. Annual metal cost inflation is the other factor. Since our fees are generally structured as a percentage of dollars saved or recovered.

On a product basis, we expect greater year-over-year revenue growth in the Payment Integrity product line this year than last. We streamlined internal processes throughout 2016 to increase the production of new PI edits and to speed their adoption by our customers. During 2017, we will be operationalizing new data technologies we expect will dramatically reduce the time for ingesting data. And significantly increase our ability to analyze it rapidly. Finally, our Six Sigma Black Belts were intensely focused last year on improving the yield and decreasing costs associated with our PI products. We expect to see the benefits of that yield improvement work reflected in higher PI revenue this year.

Our combined efforts to increase number of PI edits, accelerate implementations, and enhanced product yield add to our confidence that year-over-year PI revenue will grow at a faster pace in 2017. We also anticipate increased receptivity in the state government market to more broadly utilizing our Payment Integrity products, particularly in the 23 existing Medicaid RAC contracts, so we intend to step up PI sales efforts with our state customers this year. This expected increase in activity is included in our view that state government revenue growth in 2017 will be mid single digits. Rather than low single digit base case growth we have spoken about previously.

In terms of share repurchases, we bought approximately 1.1 million shares in the fourth quarter. At a total cost of about $20.5 million, or $17.93 per share, which nearly exhausted the $75 million authorization granted by our Board in August of 2017. Total purchases to date under that program include 5.9 million shares at an average price of $11.95 per share.

Bill will now have closing remarks and then we will be ready for questions. Bill?

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

Thanks Jeff. I want to conclude this morning with a discussion of our key strategic objectives for 2017. They fall into four broad categories. Managing big data, innovation, new product development, and capital deployment, all targeted, of course, to improving our all growth and profitability.

We intend to utilize technology and automation to create a more nimble business environment and to identify additional revenue opportunities within our current service delivery model. Doing so is both a recognition of the tremendous big data assets we have and a realization that available tools can exponentially improve processes and results.

The planned implementation this year at our Hadoop Data Lake, which we tested during the latter part of last year, is a good example. Combined with our plans for robotic process automation, which is also underway, we aim to continued streamlining processes. Which we expect will lead to increased innovation, quicker speed to market, and higher margins. Buy versus build is a constant consideration. As we pursue innovation and an important factor in evaluating acquisition opportunities. Innovation is also a strategic focus internally.

Particularly with regard to product development. A recent example of the launch an early January of a member health profile product designed to help Medicaid payers identify individuals with chronic illnesses and comorbidities or substance abuse at the time of enrollment, rather than waiting months for claims to trickle in, and members obtaining care in the highest cost settings. The key innovation involved in this, and other products under development, is data aggregation across geographies and payers.

To supplement our internal product development efforts, we are working collaboratively with customers to refine and expand our product suite. And to develop new approaches to fit their cost-containment needs. Listening to customers is key to productive and lasting relationships. But also a helpful source of intelligence about the evolving needs of payers in a market where complexity is the norm and cost pressures are never-ending.

A final area of strategic focus for 2017 is maintaining a strong balance sheet. And prudently pursuing acquisitions, which remains our top priority for capital deployment. We're actively evaluating a robust pipeline of companies to add to our core expertise, expand our data analytics capabilities, or further augment the Essette Care Management product suite.

Beyond good strategic plan, our ability to succeed in a competitive and ever-changing healthcare marketplace is highly dependent upon the hard work and ongoing dedication of the entire HMS workforce. I'm extremely grateful to all of my colleagues across the country for their contributions during 2016 and the effort I know will be forthcoming to achieve our goals in the year ahead.

Given the fluidity of the current environment, there will be most likely unexpected changes as 2017 progresses. I believe, however, that we are well-positioned to overcome obstacles which may reasonably arise because we have a well constructed strategic plan, a proven business model, a realistic sense of where our growth will come from, and how to achieve it, a cohesive executive team, with the range of skills and the commitment needed to execute our business objectives and a very able Board of Directors focused on the pursuit of long-term top and bottom line growth in order to enhance shareholder value. For all of these reasons, I'm very enthusiastic about the year ahead.

Operator we're now ready for the first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Ryan Daniels, William Blair.

Ryan Daniels - *William Blair & Company - Analyst*

Good morning. Thanks for taking the questions. Bill, one for you. Given the relationship you have with so many plans, particularly on the managed Medicaid business. Can you talk a little bit about what the hurdle has been to getting more penetration into the ASO and at risk business? Which you discussed slowly penetrated and then same question on the Medicare Advantage business. I'm curious if they already have products that you need to develop new solutions if it's a sales force investment? Any color on how you will penetrate that.

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

Thank you Brian. If we take a step back, not all of our Medicaid plans are in commercial at risk either, right? Some are Medicaid only plans. In fact, a large portion of our plants are Medicaid only. Then there are government only plans which are Medicaid and Medicare. And those we are starting to have a better penetration rate in pushing our Medicare Advantage opportunities. Which are both program integrity and COB related.

And then lastly, which you started first with was the ASO business. In reality the ASO business, the dollars that are recovered in ASO or saved to benefit the employer. They don't really benefit plan. I'm not saying they're not interested in pursuing that. I'm just saying that's not the top priority because it does not impact their bottom line. With that said, we are seeing an increased demand from the employers. Particularly through our relationships with benefits advisory firms. To achieve better results for the clients. And that push is impacting large commercial ASO plans. And we are just starting to see the benefit of that. Like the large group we signed in 2016, as well as this is the first time we've signed a third-party administrator. Which, of course, is a processor and administrator for large employers.

We are just starting to see that. Again, I think if you compare and contrast us to others, we started in Medicaid. We are slowly making our penetration to Medicare Advantage. And we have just begun the penetration into the ASO business. Which I believe may take a little longer to fully realize. But it's a big opportunity. Particularly at the employer's request better savings. And more efficiency.

Ryan Daniels - *William Blair & Company - Analyst*

Okay that's very helpful color. As a follow-up, I'm curious if you could dive a little bit more into how you are going to invest in the sales team over the next year? We saw a few years ago the investment you made in the commercial side and the benefit that is [now having very] market growth there. I want to focus more on the stateside or Medicaid side. It sounds like there's some new products to sell there. It sounds like you are going to pursue more opportunities under your RAC contracts. But those are probably less RFP driven and more proactive sales. I'm curious if you have the team built-up there already? Or if that's going to be a key investment area and when that would yield fruit. Thanks.

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

We continue to invest in sales. And I will give you two areas we are investing. So we are investing in both sales, what I would call sales technicians or sales subject matter experts to support the existing sales team. So when we're going out to talk about the care management solution or integration of a member risk analytics and care management solution, we have a subject matter expert who is really reporting into the sales team versus the delivery team. That is one of the areas in which we are making investments.

The other is the stateside. Our state business has traditionally been our RFP driven. But once you win the RFP there are opportunities in many states to either amend the contract or to just sell other opportunities in. And while we have a strong regional structure of account management staff that really open the door from that perspective, we are adding a sales staff into the state government market this year to provide additional opportunities for penetration into the large customer base. We see that as an opportunity. Particularly this year, because states are gearing up for changes that will come down the pike. Whether they are block grants or per capita funding. It's going to impact their infrastructure, how they count things and the recoveries and savings that they pursue. We think it's a prime time to make that investment. And we have also invested in advisory services group. And have won what I would call blanket consulting agreements that will also help states as they go through the process.

Ryan Daniels - *William Blair & Company - Analyst*

Okay great thank you so much.

Operator

Jamie Stockton, Wells Fargo.

Jamie Stockton - *Wells Fargo Securities, LLC - Analyst*

Thanks for taking my questions. Bill, as far as the ACA repeal and replace distraction is concerned. When I think about repeal and replace is mostly going to impact the individual market and potentially Medicaid. Right? When you are going into these health plans trying to sell additional services and technology around ASO lives or full risk lives that are not in the individual and Medicaid buckets, is there a good reason for the plans to be that distracted by ACA repeal and replace? When you think about the ASO lives and the full risk lives that are not in the individual market or the Medicaid bucket? Or, is this something that is actually just a minor distraction because it's not that big of a deal for those buckets that your hoping to more significantly penetrate going forward?

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

That's a good question. First of all, as I mentioned in the prepared remarks we don't have an exposure to the exchanges. In fact, even the plans where we are doing some auditing of their commercial block of business, they have asked us not to audit the exchange lives. Because those have been tied down to very narrow networks. And because those networks are so narrow, and have taken deep discounts, they do not want to audit those providers. But you're right. The largest health plans, a lot of small plants are not in the exchanges. So the largest health plans that have been in the exchanges and have ASO business really don't have, I would say at least the people who run their commercial line of business don't have the same concerns about what might happen with the ACA. Particularly if they made a decision to exit exchanges.

But sometimes decisions about auditing are made at a corporate level. The type of work we do could be driven by procurement. It could be driven by someone over cost-containment that rides over each of the business lines, Medicaid Medicare and commercial. And I think we've talked about this before. But as we enter the commercial market, and have a more viable product, not only in our complex clinical audits. But our data mining our hospital bill audits and credit balance audits. As we bring that set of solutions to the ASO market, and the large plans that are in it. Or the third-party administrators, it's often not a zero-sum game. Maybe they don't just higher one vendor. The larger plans higher multiple vendors. Some based on specialties, and some based on first pass or second pass on the claim. We still think there's a lot of opportunity to come in, where we can come in as a second pass and find significant value behind others that we compete with. So you're right. I don't think they're as focused on it. But ultimately there is some distraction at the plan level. Not a lot, but some distraction at the plan level. Particularly if they've got government risk in their business.

Jamie Stockton - *Wells Fargo Securities, LLC - Analyst*

Okay that's great. And then Jeff, a quick follow-up on expenses. They came in relatively contained this quarter it felt like. I know you guys said you made some investments last quarter. And there's a little mix shift it felt like between some of the lines. Can you give us a little more color on what is going on with the expense base? And how we should think about it trending as we go through 2017?

Jeff Sherman - *HMS Holdings Corporation - CFO*

Sure. I think from a cost perspective we had good performance in the fourth quarter. And we saw sequential costs declining. And saw costs down a fair amount from the fourth quarter of last year. We have been making investments to help improve our efficiencies. We've talked about making investments in big data. We are making investments in robotic process automation as well. And actually improving processes. As I mentioned in my prepared remarks through some of our Black Belt Six Sigma and how we work the business. We do, as I said in my prepared remarks, we do see margins expanding next year on an operating income line. 125 to 150 basis points. So we do think we're going to continue to get operating leverage, as we see revenue grow. And from a trending perspective, as we see revenue growth we will see cost moving with that revenue growth. But we still think about COB and Payment Integrity product lines incremental revenues will come in much higher margins than our overall margins. I think will continue to get leverage on the business as we move into 2017.

Jamie Stockton - *Wells Fargo Securities, LLC - Analyst*

Okay thank you.

Operator

Mohan Naidu, Oppenheimer.

Mohan Naidu - *Oppenheimer & Co. - Analyst*

Thank you for taking my questions. Bill, going back to your comments of the federal reimbursement models for Medicaid. What is your perception around how likely is the change is going to come? And how are the discussions going on around block grants or [cap place] models are anything you have been talking to your state contracts right now about these changes?

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

Let me take the last part first. And yes we have been talking to our state clients. In fact, that is why we have been pursuing what states call blanket consulting agreements. Because we believe there's going to be a lot of opportunity to help states figure out how do you operate in the new reimbursement model? To add a little color to this obviously today, they get what's called a federal matching rate or an [FMAP] and it's based on the level of poverty in the state. So it may range from a high of 80% in the state of Mississippi, so when we do recoveries for them 80% of the dollars go back to the feds. Versus to about a 50% match rate in California.

When you go into a block grant, where you are looking at taking, so let's take the Paul Ryan plan. Where you are taking federal of FY16 is a base line and maybe adding some [cola] to that. You're at the that as your baseline and growing a grant or a per capita payment to the Medicaid agency. And saying with that and minor adjustments each year that's what you're going to live with.

What that means is, they have to live with the smaller pool of dollars. Versus this FMAP that could increase and increase in a relatively uncapped way. And then the Feds reimburse states very differently based on system development, use of clinicians, administrative work. There are many different categories. It's very complex and there is a whole field of consultants that help states maximize that.

That could all go away based on the fact that you're going to get a block grant or a per capita grant. You will have to live under a tighter framework in terms of cost. Think about that cost pressure and what it is going to do to the states and their need to recover or save as much money as possible. We think it's very positive for us. Not only to advise them through it, but to help them for their fight fraud waste and abuse. We have an administration at the federal level who has really said that is our target. So you never know, there might even be incentives to states to invest in fraud analytics. And then lastly, that pressure is not going to just sit with the state.

The pressure is going to push hard on the Medicaid plans. And that push is typically making them do more work. And fighting hard to justify their rates. All of that pressure on the system is good. And it pushes more opportunity for HMS. I cannot tell you I don't have a crystal ball to tell you if they are going to block grants, or some combination of per capita funding. Or how they are going to change this, and how long it will take them to do it. Because today's system is very complex. But I see that pressure on the system as a positive for HMS.

Jeff Sherman - *HMS Holdings Corporation - CFO*

This is Jeff. The only thing I would add is, with that pressure and our contingency fee pricing approach, we see that as generating more opportunity for us to help them save money for their programs in a relatively low risk way.

Mohan Naidu - *Oppenheimer & Co. - Analyst*

That's great color thank you. And Jeff a quick one for you. Looking at the commercial [line] can you elaborate a little bit on where the shortfall came in? And also the single customer that you signed on with 15 million lives. Is this customer live now and revenue generating?

Jeff Sherman - *HMS Holdings Corporation - CFO*

Yes. The customer is live. But obviously a large block of lives like that Mohan, it is being rolled out over time by groups. So it is live. But we're continuing to expect to see revenue growth from that as we go through 2017. As we talked about on our third-quarter call, we needed about $10 million of sequential growth to reach our full-year growth target.

We did have good visibility in the quarter from a number of implementations that were scheduled. And we did expect the usual year-end push for our customers for additional savings. So looking back at the quarter, we had about $1 million of implementation scheduled in the quarter which did push out. Some of that will be in Q1 some that could even go into the second quarter. And we did have some year end projects that we had identified pretty significant savings for our customers. They were related to new not previously worked. So we did not receive final approval from several customers to proceed before year end. And finally the last thing impacting is, we did have a large national customer that did [pause] some PI auditing in the quarter. Due to concerns about year end ratings from their provider network. At a high level, these items with the principal contributors to roughly the $5 million difference from where we ended up to our guidance range.

Mohan Naidu - *Oppenheimer & Co. - Analyst*

Got it thank you very much for taking my questions.

Operator

Dave Windley, Jefferies.

Dave Windley - *Jefferies LLC - Analyst*

Thanks for taking my questions. I had not heard the Company mention Medicaid RAC for quite a while. And in your prepared remarks you referenced that in the context of ramping up your activity into states. Could you talk about, I'm sure you do not want to go into great detail. But talk about the status of Medicaid RAC as it relates to being a fertile seedbed for you to launch that stepped-up sales effort.

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

Dave, that's a good question. States initially, I'd say about half of our clients felt that Medicaid RAC was a must do. Because the federal government pushed the requirement on them. I think the other half of the states said, actually this is a pretty good tool for us to use. We have other contractors that do other things on a cost-plus basis. And utilization management, which of course HMS does as well in some states. But they viewed it as an opportunity to create fiscal results and augment their existing investigators.

We are out now spending a lot more time with those states that have a real vested interest in improving and really increasing their recoveries. And increasing their fraud identification to fit more opportunities under the Medicaid RAC umbrella. We think the states will use Medicaid RAC a little more broadly in the future. And that is why we're amping up both our sales activities into that space. But also our discussions and dialogue with states about how that contract vehicle may be used.

That is really the approach. States have the same, I'd say provider reaction that the federal government had when short [stay] auditing was done. You will not see states primarily doing short stay audits. Or audits related to questioning provider judgment from a clinical perspective. But they have the same issues when it comes to DRG or ATC. Or other types of coding irregularities. And they have the same issues related to data mining and or potential fraud. So, we think this is a good time to engage with both state Medicaid agencies and the (inaudible) and other governing agencies in Medicaid to utilize those contracts

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Jeff Sherman - *HMS Holdings Corporation - CFO*

We are continuing to ramp up our PI edit development. And so there could be some state specific edits where we're focused on developing that would help drive more state revenue as well.

Dave Windley - *Jefferies LLC - Analyst*

In terms of the catalyst I guess, your point about states looking to use this vehicle more. Has there been a change in regulation? Some stimulus from the feds? Or is it perhaps just the uncertainty around perhaps going to block grant or per capita that is stimulating this thought process on the part of the states?

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

There has been lots of public debate up until the end of the last administration. And the Center for Program Integrity at CMS has been brought to congressional inquiries for it seemed like almost every other week. Pressure on improving Payment Integrity and attacking fraud and abuse in both Medicare and Medicaid programs. So it's not that pressure does not trickle down to the states.

And we think there is going to be increased pressure, ultimately. When all of the new administration, the Deputy Directors, all of the people put in place. There's going to be increased scrutiny at the federal and state level on program integrity. Particularly around fraud and abuse but also around these overpayments which are still rampant. 12% in Medicare sub 10% in Medicaid.

We think that is going to continue to increase. And we have been investing in what we call edit development. But it's really refining and improving your algorithms and applying them to the state Medicaid programs. Which as a reminder, still have in many cases, the highest cost members. They are managing the dual eligible that are harder to coordinate. And potentially have the higher opportunity for errors. Because you are managing it through multiple programs.

There has not been one single stimulus, I think it's multiple pressure that has been placed on the states. And that will continue to be placed on states. And there was this mega rule that came out in the summer for states will be much more vigilant about managing their managed-care plans through this process. And assuring that they are identifying fraud waste and abuse and reporting it up to the states.

Jeff Sherman - *HMS Holdings Corporation - CFO*

Finally I would add obviously we have talked about Medicare RAC ramping up a little bit slower from this year versus last year. We do have some incremental bandwidth with our resources to focus more on the state market as well.

Dave Windley - *Jefferies LLC - Analyst*

If I could sneak one more in. You mentioned provider sponsored plans or PSPs and that does seem like a ripe customer target for your care management capabilities, if you can garner their attention. Would your pricing to thinking also that those PSPs would be on average, smaller from a membership standpoint, than certainly some of your big national plans that are purchasing a lot from you. I'm curious if the pricing to that market scales relatively to their size? Or would your pricing in the care management model be more of a flat charge to a customer regardless of size?

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

That's a good question. We price to be competitive and make deals. But in reality, the pricing model that was traditional for Essette in the care management platform was a perpetual license fee with a large license payment upfront. Implementation fees and then annual maintenance. Typical software delivery model on a premise-based solution.

We have started to migrate them to a SAS-based solution. Expect the next release to include a cloud-based solution. Many of those include an implementation fee and then a per member per month fee managed on the system. Sometimes it's a per user. We, of course, are going to be flexible based on market. But we think there's opportunity in that market. I would say about half of the Essette clients that we assumed through the acquisition our providers that take risk. The other half are health plans. We don't believe that just care management is applicable though to that marketplace. When you think of some of the very large organizations that are providers taking risk. Or hospitals building health plans regionally, they need the same types of cost containment solutions that we traditionally offer. Particularly if they're taking Medicaid risk. We see that as a good opportunity both directly selling it to them and then through partners.

Jeff Sherman - *HMS Holdings Corporation - CFO*

And generally they have little to no infrastructure to actually do that work. So we do see that as a good opportunity.

Dave Windley - *Jefferies LLC - Analyst*

Great thank you.

Operator

Robert Willoughby, Credit Suisse.

Robert M. Willoughby - *Credit Suisse - Analyst*

A quick one. Your DSO profile ticked higher into 2014 on the expansions in the Medicare business. As it's come down, that Medicare exposure to DSOs are back down. The cash is coming in nicely. What is the new norm for a DSO? Can you get back to historical levels? Or does that commercial book of business or any other change in the profile with Essette or whatever you have to limit your ability to improve that metric further? Or do see more room to run there?

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

Yes we been in a relatively stable range obviously for this year. And have had good cash collections and good cash performance. We had a strong finish to the year with cash both from ops of over $30 million. I think as commercial business grows, and we're dealing with Payment Integrity work where you have actually go back and get dollars back from providers, we do see that having an impact on DSO. I think we have mitigated as we have seen our business shift to commercial, I think we have been able to mitigate that rise with improved focus on cash collection. But I think we relatively stable range now. And potentially additional incremental improvements in our cash collection process will probably continue to offset growth in the commercial business from a DSO standpoint.

Robert M. Willoughby - *Credit Suisse - Analyst*

How much of the improvement we see today was just simply mix and how much was something that you have controlled through internal improvements?

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

I would say we probably have seen a five day plus improvement in terms of just collection efforts. And again, continue to see that commercial growth drive DSOs the other way.

Robert M. Willoughby - *Credit Suisse - Analyst*

Great thank you.

Operator

Matthew Gillmor, Robert Baird.

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

I had one left which is on the commercial growth guidance for 2017. You mentioned that part of the outlook is based on some expected sales activity over the next two to three months. Can you give a sense for how much visibility have on those contracts? Are those negotiated and just waiting to be signed or of those earlier on the process? Thanks.

Jeff Sherman - *HMS Holdings Corporation - CFO*

We track sales, Matt and salesforce. And assign probabilities to those. When we get above a 75% probability and moving into the 90% probability, we have pretty good sense on completed sales. I would say good visibility on sales we expect to happen over the next couple of months. As we said in our prepared remarks, as we are continuing to invest in big data technology, we do believe that's going to continue to shrink that ink to green. The technology component data ingestion management of data interfacing with our clients is one of the biggest hurdles in terms of the whole ink to green process. And we have certainly made a commitment. We are going to spend another $6 million or $7 million specifically on just big data investments. That started in the second half of 2016 going into 2017. As those investments, as we start getting the ability to ingest massive amounts of data more efficiently and more effectively, we think it's going to help ink to green. So, meaning that we could even see some sales in the second quarter. As we improve that potentially generate revenue in 2017.

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

Got it thanks Jeff.

Operator

Steve Valiquette, Bank of America.

Steve Valiquette - *BofA Merrill Lynch - Analyst*

Thanks. Good morning everyone. When we think about the new business signings for 2017, the way you are factoring that into guidance I was curious whether or not the way you are approaching revenue outlook for 2017, is this different than what you've done in the past? Or is this standard operating procedure? The way you're factoring in the potential new business signings and the business you already have? Clearly, 2017 is a little bit year, different political environment. Is there is ready extra level of conservatism baked in the guidance on revenue outlook? Just rather curious to get your thoughts on how this year is going to differ on your approach to the revenue outlook versus what you've done prior years. Thanks.

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

I would characterize it as very similar as we approach 2016. When you are dealing with multiple customers buying many products, which have differing implementation times, we always know as we do a budget we're going have some pluses and minuses. Both in the COB and Payment Integrity side. And both in the state and commercial health plan marketplace. We have pretty discrete budget forecasting at a customer level. We obviously have some factor for new sales in there as well. And I would remind everyone yield improvement continues to be an area we're focused on as well. Which is just generating more revenue from our existing customer base. We continue to see that as a growth opportunity. Those investments in big data are going to help drive incremental yield improvements as well. Yield improvement for us, is really all margin. There is very little incremental cost, other than technology investments I spoke about. So once we make those investments, additional yield drive really has a very high margin. So, I think all of those items continue to be factored into our revenue forecast and our guidance.

Steve Valiquette - *BofA Merrill Lynch - Analyst*

Okay. And then real quick. You touched on this as well. But should we assume given the increased uncertainty from the overall political environment, I have believe that's probably dramatically increased the M&A pipeline opportunities that you're looking at right now. Maybe the odds are a little higher that we could see potentially more aggressive M&A activity [from you guys] over the next one or two years. Versus what we have seen previously. Is that a safe blanket statement to make right now?

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

We've talked about being very focused on M&A, and it being a key user of our free cash flow and our [significant] liquidity. We have also spoken about, we do expect to see consolidation occur over the next couple of years. Our largest customers have been telling us there want to deal with less vendors. They want to deal with less from a complexity standpoint. They also want to deal with less vendors from a data security breach standpoint. And I think we are well-positioned. As we have very strong core COB platform. We have a growing PI platform. We have a new platform on risk bearing management. And helping companies do that. As that consolidation takes place, we are confident we're going to have a seat at the table. And then predicting when deals are going to happen is difficult. That's why we don't include deals in our guidance. But we certainly continue to see a very active robust pipeline. And expect to be making acquisitions that could either help our core business or our new growing business with the foundational acquisition we made with Essette.

Steve Valiquette - *BofA Merrill Lynch - Analyst*

Okay great. Thanks.

Operator

Shane Svenpladsen, Avondale Partners.

Shane Svenpladsen - *Avondale Partners - Analyst*

Good morning. Following up on your Medicaid RAC comments. How would you characterize the competitive environment in that market?

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

It is a good competitive environment for us. Because we have so much domain expertise in Medicaid. We have seen a lot of people who have been in the market drop out. We have about 23 contracts currently. We selectively rebid on them primarily based on states who have an interest in actually pursuing these savings. Versus them seeing it as a compliance issue with CMS. We think we're going to continue to have a very strong footprint in the Medicaid RAC environment. We think this is the time to move the needle, when it comes to both bringing in the expanded sales team. And then pushing more of our focus on edit development. Particularly when there is a lull in the Medicare RAC environment into Medicaid

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Jeff Sherman - *HMS Holdings Corporation - CFO*

And typically in the state marketplace versus the commercial marketplace, it's an RFP process. So vendors are not typically stacked in the state contracts. You win the RFP you are the vendor doing the work.

Shane Svenpladsen - *Avondale Partners - Analyst*

I appreciate that is helpful. Quickly, has there been any update on the UPIC contract vehicle since you last spoke about?

Jeff Sherman - *HMS Holdings Corporation - CFO*

Yes. As everyone knows, we were one of seven companies selected last year to compete for what is about $2.5 billion over 10 years. The selection of us does not mean we're going to win something. But it does provide us an opportunity to both compete for the business and also be pre-approved by CMS either as a primary contractor or subcontractor. There are five jurisdictions that are expected to be awarded over a period of about 12 months. That may take longer. Sometimes it does, particularly with change in administration. The first award was made last summer for jurisdiction one. We were not part of that bid. The second was announced in October for the Northeast region. And we are a subcontractor in that bid. We've opted not to bid as primary. But because we're in a approved bidder, it's easier for the primary to get us approved as they go through their bidding. And then the final task orders were just released and proposals are due this month. We expect they will start to announce those in April. We will not necessarily talk about what we bid on or whether we bid prime or some but our goal is to be part of this.

The other part of these dollars that CMS has to spend is we may come up with a very unique strategic data aggregation project. Considering the amount of Medicaid data we have, propose that to CMS. CMS might say that sounds great. We have to put it out to the UPIC vendors. They put out to the UPIC vendors and so it's a bit I don't use the term hunting license. But it is a bit of that. It's an opportunity for us to propose new projects to CMS and for CMS to say these make absolute sense let us put it out for the UPIC procurement process. To the pre-approved vendors. That is a current update on the UPIC. It's cost-plus business as everybody knows. A little less from a margin perspective than our typical margin run rate.

Operator

Frank Sparacino, First Analysis.

Frank Sparacino - *First Analysis Securities - Analyst*

I know we are running way over. Real quick on the Payment Integrity side for 2017 I know you talked about an improved growth rate. Any color you can add there. 2016 was obviously weaker than we had expected. I think given the sales activity skewed towards the PI side. I would assume material improvement but any thoughts?

Jeff Sherman - *HMS Holdings Corporation - CFO*

Yes. I think as we said on prepared remarks, a majority of our sales over the past year were more focused Payment Integrity products. It is more complex to implement than COB contracts. So it does take longer for them to be revenue producing. Factors including client collaboration, the availability of prioritization of IT resources are critical factors in the process. It's also, once PI contracts are in place, the revenue can be uneven from quarter to quarter. It is a category where, as we find new edits and those get fixed over time, you have to keep generating new edits. So I think the resources we have put into new edits development will be helpful. In driving additional PI revenue in 2017. And then finally, as I said previously, the investments we're making. Both in implementation resources and in technology infrastructure [then just data] quickly. All the things that will help drive more Payment Integrity revenue growth in 2017 versus 2016.

Operator

I'm not showing any further questions at this time.

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

I thank everybody for attending our call. I look forward to speaking with you on our next quarterly conference call. Thank you.

Operator

Ladies and gentlemen this does conclude today's presentation. You may now disconnect and have a wonderful day.
