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HMSY - Q1 2015 HMS Holdings Corp Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the HMS Q1 2015 earnings conference call. (Operator Instructions). As a reminder, today's conference is being recorded.

I would now like to introduce your host for today's conference call, Mr. Dennis Oakes. You may begin, sir.

Dennis Oakes - HMS Holdings Corporation - SVP, IR

Thank you, Kevin. Good morning and thank you for joining us for the HMS first-quarter 2015 earnings conference call. With me today are Bill Lucia, our President and Chief Executive Officer, and Chief Financial Officer, Jeff Sherman. As you know we distribute our earnings release through the Company website, HMS.com at the investor relations tab. We also posted a quarterly investor presentation containing supplemental information but 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 investor relations site. A replay of the call will also be posted later this morning.

Let me remind you that some of the information presented today regarding the Company's future expectations, plans and prospects is considered forward-looking statements under the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are based on the Company's current expectations and actual events may differ materially from those expectations.

We refer you to the Company's filings with the Securities and Exchange Commission including our annual report on Form 10-K and our quarterly reports on Form 10-Q. Those filings identify important risk factors that could cause actual results to differ materially from those contained in the Company's projections or forward-looking statements.



All information on this call is as of today May 8, 2015, and the Company disclaims any intent or obligation to update any forward-looking statements as a result of developments occurring after this call. During the call we will be referring to certain non-GAAP measures. Our press release issued this morning includes a reconciliation of those measures to GAAP.

We are ready now to begin. Bill?

Bill Lucia - HMS Holdings Corporation - President and CEO

Thank you, Dennis, and good morning, everyone. We were very pleased with the year-over-year revenue growth we experienced in the first quarter. New commercial sales which will not be reflected on the revenue line until much later this year were also very encouraging as was the 25% growth in our coordination of benefits business.

First-quarter revenue, excluding Medicare RAC, was 15% higher than the year-ago quarter and well ahead of our expected full-year growth in the 7% to 9% range. The upside however was driven by a 15% jump in year-over-year state government revenue that we do not expect will continue through the balance of this year. The increase appears to be a spillover benefit related to individuals who enrolled in Medicaid toward the end of 2014 and particularly the cost avoidance work we do for states prior to actual claims being generated and even in situations where those individuals ultimately migrate to managed care.

Coordination of benefits continues to be our largest product line across both the government and commercial markets generating approximately three-quarters of our Q1 revenue. The increase in state government cost avoidance work in the quarter was a factor in the large year-over-year increase in COB revenue but commercial COB growth was also a contributor.

The commercial sales team, which we expanded over the second half of last year, is off to a fast start. Strong first-quarter sales included 1.2 million lives added to our commercial customer base of over 80 million. In addition, we sold new products to current commercial customers covering approximately 3.9 million lives. The new customers included four regional Medicaid managed care plans while product expansions included adding services to a significantly expanded population of two of our larger Medicaid plan customers.

We also initiated pilot projects in the quarter with a large health plan which illustrates our growing partnerships with important customers and their appreciation of the expertise HMS brings to the design of new and innovative solutions. It is premature to discuss the details of these pilots but they are a further indication of a growing focus by our influential payer customers on addressing errors and containing costs.

Converting new sales to revenue in the most expeditious fashion possible for our customers and HMS continued to be a challenge in the first quarter. Shortening the time from ink to green which is how we refer to the gap between contract signing and revenue production is a high priority for the entire HMS organization in 2015. To address the situation we have restructured our implementation teams to increase scalability, added measurable quality standards and key performance indicators so we can better track performance and identify opportunities to improve processes. And finally, we are beginning discussions with customers about data requirements, the scope of work much, much earlier as part of the presales activity. All of these efforts are designed to smooth out and shorten install times which is increasingly important as we sell more and more into large and complex organizations.

On the state front, while only two of the 12 state contracts up for re-procurement in 2015 have been finalized, there has been quite a bit of activity since our last call in late February. Massachusetts extended our current contract for 21 months until December 31 of 2016 and we won a competitive bid to continue pursuing casualty recoveries for the state of Wisconsin.

Massachusetts is one of our top 10 state accounts in terms of annual revenue and the Commonwealth has been a customer for 25 years. Wisconsin casualty award was a relatively small contract and we do expect a separate RFP for Wisconsin's TPL business later in the year.

Our responses to the New York, New Jersey and New Mexico RFPs were all submitted within the last 10 days. We have agreed to a 90-day extension with New Jersey which pushes our existing contract to July 31.



Our New York contract does not expire until January 6 of next year pursuant to the one-year renewal option exercised by the state this past January. And we have also responded to Florida's invitation to negotiate for their TPL business. Two additional RFP responses were submitted in the first quarter, Oklahoma and Kansas TPL contracts. The Oklahoma engagement is scheduled to expire on June 30.

In Kansas, we are actually a subcontractor to the state's MMIS vendor and that current contract runs until June of 2017. Such a lovely time is not unusual for large MMIS procurements.

In addition to Wisconsin, we expect Illinois, Tennessee and Washington state to issue their respective RFPs by the end of this year.

2016 will be a below average year in terms of state government re-procurements. In addition to Massachusetts, only a handful of state TPL contracts will be up next year. Collectively they represent less than 10% of projected 2015 state revenue. We are assuming states with extension options such as North Carolina will exercise them as they have done so historically.

We continue to be highly confident in our ability to compete successfully for state business. Our value proposition is simple. We believe we offer the largest warehouse of Medicaid claims and eligibility data, the most comprehensive suite of COB services, the longest track record of innovation and reliable year in and year out cost recoveries and savings for the states we serve all resulting in a compelling ROI for our customers.

Jeff is up next and he will provide some additional color on our first-quarter results. Jeff?

Jeff Sherman - HMS Holdings Corporation - EVP and CFO

Thank you, Bill, and good morning, everyone. The strong growth we experienced in the first quarter puts us on a clear path to achieve our full-year revenue projection which excludes Medicare RAC. Despite the large year-over-year increase, total revenue in the first quarter of \$108 million excluding Medicare RAC was a small decline from the fourth quarter of last year which is typical of revenue performance over the last few years.

On a trailing 12-month basis however, total non-RAC revenue of \$435 million for the period ending March 31 was 3.3% higher than the preceding 12-month period ending December 31 of 2014. As we have pointed out previously, it is reasonable to expect ongoing variation from quarter to quarter in many of the components of our key metrics including revenue and customer membership growth. In general, we expect total revenue to increase from quarter to quarter throughout the balance of this year though state government revenue should decline from the first quarter level.

On the fourth-quarter earnings call, we commented on the strength of the state government revenue in 2014 due in large part to the significant increase in new enrollees as a result of the ACA and initial cost avoidance work completed on those new members. We saw a similar spillover effect in the first quarter.

State revenue growth ramped up significantly throughout 2014 with a particularly strong third quarter. We expect state revenue year-over-year growth to decline from the first quarter pace in 2015 as a result of the strong prior-year comps and the slowdown in ACA membership growth projected for this year. On a full-year basis, we continue to expect state revenue will be flat with the prior year.

\$43 million in first-quarter commercial revenue was only about \$1 million short of our full-year 20% growth target. Since roughly three-quarters of all Medicaid enrollees are now going into managed care, Medicaid expansion continues to positively influence the growth in our commercial membership and revenue.

As of the end of this February, CMS has reported an increase of 11.7 million new Medicaid enrollees compared to the beginning of marketplace open enrollment on October 1, 2013. We have approximately 10.5 million or 90% of those individuals in our customer eligibility files. Many states such as Florida, Maryland, Texas and New Jersey require 30 to 60 days and fee for service which generates an initial cost avoidance work for us in those states before individuals move to managed care and begin to incur claims. As a result, there is a lag time between new Medicaid enrollment and new revenue from our commercial customers in managed Medicaid plans.



As we saw in 2014, we expect commercial revenue to increase over the remaining three quarters of this year with the second quarter coming in higher than the first and the second half averaging above 20% growth so we achieve our full-year commercial growth target of 20%.

Payment integrity revenue excluding Medicare RAC at approximately \$25 million in the first quarter was about 10% below the first and fourth quarters of last year. Even though sales of various payment integrity products are healthy, we have not yet seen the expected revenue impact. Though pending implementations are a factor, a portion of the delays are the result of commercial payers deciding to slow down or defer implementation of short stay auditing consistent with the moratorium which was recently extended by Congress until September 30 of this year.

With regard to Medicare RAC, we are hopeful that during this calendar year the pending litigation will be resolved so CMS will make final awards under the new program and revenue could begin to flow in 2016. Our Medicare RAC revenue in the first quarter was \$2.3 million so in the ballpark of our quarterly run rate expectations for that business this year.

Unfortunately the RAC program is no longer the robust recovery effort for the Medicare Trust Fund it once was. We have not received any indication from CMS however that they will be broadening the scope of auditing under the current contract in the short term.

Moving from revenue to expenses, our process improvement initiatives continue to show benefits as the total cost of services in the first quarter was up less than 1% compared to the prior year first quarter despite the significant revenue growth. We enhanced the profitability in our COB business during 2014 as a result of product yield improvements. Our focus this year is the payment integrity product line and we expect to achieve yield improvements there as well though the impact of those efforts will not likely be evident until the second half of the year.

First-quarter adjusted EBITDA of \$24.5 million reflects those initiatives and was meaningfully higher than in prior quarter which included unusual items that negatively impacted EBITDA and slightly ahead of the prior year first quarter. We will continue throughout 2015 to identify and implement cost savings opportunities across the organization in order to expand margin and to make our entire Company more efficient.

We expect cost savings over the next two to three years can continue to offset a portion of the expected incremental cost of growth.

First-quarter total operating expenses were about \$5 million higher than the year ago quarter but about \$10 million lower than the fourth quarter of last year. The sequential decline relates primarily to the unusual items last quarter which totaled \$12.1 million. About half of the year-over-year increase relates to BCG litigation expense which totaled \$2.7 million in the first quarter. The balance of the increase is attributable to the higher contract services including temporary help and subcontractors that will fluctuate with volumes.

Cash flow from operations was a negative \$95,000 in the quarter compared to positive cash flow of \$21.3 million a year ago. The two main items impacting cash flow in Q1 were a reduction in current liabilities of \$12.4 million and an increase in AR of \$9.3 million versus the year-end balances. Current liabilities declined in Q1 due to the payment of \$4.3 million in legal fees, \$1.7 million in CapEx and 2014 bonuses all of which were accrued in prior periods.

AR increased due to lower Medicare RAC collections as a result of difficulties we experienced with the CMS portal that allows RAC auditors to create invoices and bill CMS. CMS RAC cash collections declined by \$4.7 million in the first quarter as compared to the fourth quarter of 2014. The issue was corrected in April and a payment from CMS is expected in June.

In addition, two large commercial clients experienced processing delays in the quarter. We received a payment in April from one of the clients and the other client went through a system conversion in Q1 with payment expected in the second quarter. Cash collections from these two commercial payers was \$2.9 million lower in Q1 as compared to the fourth quarter. We expect cash flow to return to the \$20 million to \$25 million per quarter range throughout the balance of 2015.

As anticipated, we returned to our normalized tax rate of approximately 42% in the first quarter and continue to expect the full year to be at that level as well.

Our outlook for the year is unchanged from the view we expressed on our fourth-quarter earnings call in February and we remain comfortable with projected non-Medicare RAC revenue growth in the 7% to 9% range. We will have a better view as the second quarter progresses but based on the RFPs we have seen so far, seven of the expected 11 with Massachusetts now deferred for a year, we have not seen any meaningful change in the scope of services being secured that would negatively impact our view of 2015 state revenue assuming we successfully retain the existing relationships.

As noted, we feel good about the projected commercial growth that will drive our expected full-year growth.

Touching briefly on capital allocation before turning the call back to Bill for closing remarks, our primary focus continues to be acquisitions that would complement our core business, expand our data analytics capabilities or extend our fraud, waste and abuse prevention service offerings. We ended the quarter with approximately \$134 million in cash which gives us the flexibility to deploy capital opportunistically. Bill?

Bill Lucia - HMS Holdings Corporation - President and CEO

Thanks, Jeff. To sum up, 2015 is off to a good start in terms of revenue and profitability. Overall we continue to expect full-year growth consistent with our initial guidance in February and a gradual quarterly step up throughout the year. We are still in the early innings of tapping the full potential of the commercial market and remain confident in our ability to reach and sustain annual growth of 20%. That confidence comes from the sales traction we were experiencing bolstered by our large and growing customer base and a track record of delivering ROIs at 10 to 1 and higher.

We also feel good about our prospects in the 2015 competitive process for state Medicaid contracts. Finally, the overlay of a very favorable macro environment due principally to the ACA's impact on Medicaid, the demographics of Medicare, and the very large addressable error market in healthcare claims, strengthens our positive view of the opportunities in front of us.

We are now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jamie Stockton, Wells Fargo.

Jamie Stockton - Wells Fargo Securities - Analyst

Thanks for taking my questions. I guess and I know this is a sensitive topic, but can you give us any sense on the re-procurements of what limitations you think are in place for PCG, when they are also trying to bid on these contracts? Any color you could give there would be great.

Bill Lucia - HMS Holdings Corporation - President and CEO

Jamie, it is Bill. I guess what I would have to tell you is we are particularly sensitive to this because we are in active litigation with PCG. So I would only refer you to public documents but I would also say that as we said in the prepared remarks, we are very confident about our competitive position in this space.

Jamie Stockton - Wells Fargo Securities - Analyst

Okay. Jeff, the litigation expenses, do you have any ballpark for what you think they're going to be for the full year?



Jeff Sherman - *HMS Holdings Corporation - EVP and CFO*

No, we haven't given a range. We spent \$7 million in 2014 and we had \$2.7 million in the first quarter. So we are not providing any more information on that. We will just have to see how it unfolds.

Jamie Stockton - *Wells Fargo Securities - Analyst*

Okay. Maybe one more, Bill. Can you give us some sense for what is kind of the latest and greatest language you have gotten from CMS around what they expect from a timing standpoint on Medicare RAC? It seems like CGI was successful in their lawsuit appeal but the government has indicated they feel like they could just add a waiver to the existing procurement and move forward with it. Any more color would be great.

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

I wish I could give you more color. Our conversations with CMS just about daily operations don't necessarily include discussions about the re-procurements because they are in the middle of what is viewed by them as litigation. We are not party to that litigation obviously so there has been back and forth with the court and CMS. We are just not, we don't really know the timing of when they will resolve this and either reissue re-procurements or issue awards so our focus is on elsewhere at this point.

Jamie Stockton - *Wells Fargo Securities - Analyst*

Okay, that is great. Thank you.

Operator

Charlie Strauzer, CJS Securities.

Charlie Strauzer - *CJS Securities - Analyst*

I was hoping you could give a little bit more color if you could on the decline in the program integrity revenue in the quarter and kind of the things that are kind of going on to try and write that and get the growth that was driven there? Thank you.

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

High, Charlie. It is Bill. So a couple of things that I would like to highlight there. One is I don't want to use the word cyclical but program integrity revenue, part of the lumpiness that comes with some of the work we do is that we are finding errors, sometimes they are significant errors and in the commercial market many of our clients are relatively quick on solving the error once we find it. So an example might be if we find a particularly troublesome billing error within a quarter, we find it, we do a retrospective recovery from the providers and audits, it may last a quarter or two on our revenue and then the client has fixed it prospectively from that point forward.

Of course we continue to run these algorithms and scenarios to make sure that they don't have those problems and then it is up to us to implement new activity.

The other is just that we had this significant sales spike so to speak in terms of new signings for program integrity but as I mentioned, our implementation process and I would say the engineer processes around that did not keep up with demand so that is what we are focusing on heavily as a company and I think what we will see by the end of 2015 is a return to growth in that product line.



Charlie Strauzer - *CJS Securities - Analyst*

Great. And then just on Florida, just can you give us a sense on timing and also was the -- do you believe the scope was increased in terms of your role there? I know you are probably now more in the prime position versus the sub position but a sense of scope there about was this finalized?

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

So the Florida invitation to negotiate is still considered an open procurement though I believe the state has said they are intending to publish the award next week. Then the scope of work under that procurement is larger in general than the prior scope of work so they did add a couple of additional services into that procurement.

Charlie Strauzer - *CJS Securities - Analyst*

Excellent. Thank you very much.

Operator

Ryan Daniels, William Blair.

Ryan Daniels - *William Blair & Co. - Analyst*

Bill, one for you as a follow on there. In regards to the pilot project, is that the prepay solutions that you have launched, number one? Number two, if that is successful, would that likely become more of a recurring sales stream versus some of the work you described that might ebb and flow as you find errors and your clients correct them?

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

Thank you, Ryan. That is a good question. So no, the pilots that we are working on are just new, some are innovative, some are just expansions of different types of audit categories. Let me give you a little color around that.

For some of our larger accounts were a significant portion of their cost containment strategy so as they identify an issue, we identify and issue potentially but they may identify an issue in an area of audit that we are not even pursuing more specific provider type. We have regular calls with them where they are asking us can you now perform this type of service? Is there a pilot we can do to see if it is worth the opportunity for you to build some infrastructure around this initiative?

So those are the kinds of partnerships we are having. In our prepaid clinical audit application, we are announced a test this month with the first client and then of course we have the sales queue of customers for that opportunity. And you are right in that long-term that would mitigate some of the problems in retrospective auditing in the ebbs and flows because we are seeing those claims, helping the client disposition them and/or do a more complex audit prior to the actual payment of the claims to the provider.

Ryan Daniels - *William Blair & Co. - Analyst*

Okay, great. And then Jeff, a follow-up.



Jeff Sherman - *HMS Holdings Corporation - EVP and CFO*

(multiple speakers) interest in that from payers obviously because it can help prevent provider abrasion by doing it on the front end.

Ryan Daniels - *William Blair & Co. - Analyst*

Jeff, a follow-up for you. I know you probably don't want to get in the habit of quarterly guidance but given the strong state government sales growth this quarter and your reiteration of flat growth for the year, can you maybe help us calibrate a little bit when we will see the rollover in sales growth in 2015 meaning might it be modestly positive still in Q2 and then flat to negative in the back half of the year? Is that a good way to think about it?

Jeff Sherman - *HMS Holdings Corporation - EVP and CFO*

I don't want to get into specific quarterly revenue guidance but again keep in mind we did have a fairly significant increase both on the state side and the commercial side moving from Q1 to Q2 of last year. So part of this is just going to be the strong comps. And I think the other challenge is particularly trying to be precise on the timing of new enrollees coming in and when that Medicaid revenue is going to hit on the [cav] work.

So I think you could see some in 2Q too as well from prior year enrollments but I think overall we still expect state revenue growth to be flat for the year and again Q3 in the state revenue side was up even quite a bit larger than Q2 was. So I think on balance when you look at it from the strong comps and what we are expecting from the tail off and growth, keep in mind Medicaid enrollment growth in states that we were expanding last year was in the 20% to 30% range. Overall projected Medicaid enrollment growth is projected to be 6% this year so just the flow of that we would expect less incremental impact as the year progresses as compared to 2014.

Ryan Daniels - *William Blair & Co. - Analyst*

Okay, that is very helpful. And then last one I guess another modeling, you talked about some of your efforts to reduce the ink to green timeframe that you were making. And I'm curious if that is fully reflected in the cost structure this quarter or should we be cognizant of maybe some more expenses starting to flow through the income statement going forward? Thanks.

Jeff Sherman - *HMS Holdings Corporation - EVP and CFO*

We will see some cost impact from that but we are also trying to continue to improve our efficiency, efficiency operations, things to make the Company more efficient. So I also expect we would see additional revenue that we are expecting from that as well.

So I wouldn't expect that there would be material increases in costs there but we are investing in that ink to green in terms of additional resources and so we will see some of that but I wouldn't expect it to have a material impact in the back half of the year.

Ryan Daniels - *William Blair & Co. - Analyst*

Okay, perfect. Congrats on the strong start to the year, guys. Thanks.

Operator

Richard Close, Avondale Partners

Richard Close - *Avondale Partners - Analyst*

Thank you. Congratulations as well. I am just curious, Bill, if you can talk a little bit around the commercial and obviously you said you had good sales or bookings, I assume you are meaning there in the first quarter. Can you talk a little bit about the conversations that you are having with the commercial providers? And it seems like they are eager to sign on to you but then once you sign the contract, these implementation delays, what is really holding them back from going I guess full speed on implementation?

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

It is not necessarily -- let me give you a little bit I guess from our perspective, some of the lessons that we learned through selling into these much larger and more complex organizations.

We've have had -- the customers that we sell to do have an appetite to make sure that they are doing everything to be compliant, make sure their providers are compliant, that they are containing costs, that they are better understanding the risk profile of their members, that audits are being performed and being performed accurately. What we found through the last year was that we didn't necessarily engage all the stakeholders in the presales activity so an example would be selling to someone who is an executive over cost containment in a large national plan but then they needed to go to their individual state plans to get sign off. That may have happened after the sales close. It may not have met with their chief medical officer.

So those are things that we have now fixed, it is being done in presales activity. We have more insight into how a national plan with say 10 to 15 state health plans may roll out and those are the kinds of things we are learning as we have gone into a much more complex organization.

Jeff Sherman - *HMS Holdings Corporation - EVP and CFO*

We have also ran into IT challenges and just providing the information to us in a format that we can use. We are pretty flexible on the types of data and they way we can incorporate data but sometimes our customers have a challenge or they have different IT priorities that we have to get into the queue for that work to be done.

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

Yes, that is another critical stakeholder that we have to make sure is on board early on in the sales process. Then of course for expansion sales, so existing clients that already are integrated, we have integrated with their claims systems, front and back, those have lower lead times on implementations other than working through policy issues and as I said working with the other stakeholders in the organization.

So I don't think it has necessarily been resistance as much as it has been lack of best coordination efforts across the organizations.

Jeff Sherman - *HMS Holdings Corporation - EVP and CFO*

I would just add we also have to work with just their desire to work with their providers and minimize provider abrasion so there will be times where they want to roll out audits over a period of time to providers and we have to be responsive to that.

Richard Close - *Avondale Partners - Analyst*

And as you think about the RFPs or rebids that you have submitted and the ones planned for the remaining of the year, any thoughts about the pricing environment? And I guess maybe a breakdown, New York was I believe a winner take all and New Jersey was divided up into different parts. How are the other contracts potentially laid out?



Several questions there, sorry.

Bill Lucia - HMS Holdings Corporation - President and CEO

Let's start by the last. I mean most of the procurements, most of the procurements that we see in this arena are winner takes all or there is varying scope of services. So some are extremely comprehensive services, some are just a sliver of the kind of services we provide. Unfortunately we would of course would like to have full scope in every state that we work in. So the procurements are all different. We are highly confident about our competitive positioning. We are in the middle of these active procurements so we are not going to talk about pricing during an open procurement. But I would just say that our competitive position continues to be strong, we still continue to be the best provider of these services with the highest return on investment that our customers receive.

And then I think through the balance of the year, the rest of the procurements we don't know what they look like until they come out but we don't really know of any at this point that are, that break the procurement into multiple awards.

Richard Close - Avondale Partners - Analyst

Okay. My final question would be capital deployment. Jeff, I think you said acquisitions. Can you talk about the acquisition environment, are you actively pursuing discussions with companies and any thoughts in and around that?

Jeff Sherman - HMS Holdings Corporation - EVP and CFO

Yes, we are actively pursuing discussions with potential acquisitions. I would say we have got a fairly robust pipeline of deals that we are looking at. We are in various stages of performing due diligence. We will see how it plays out but we do see acquisitions being an important part of our growth strategy over time. It has historically been for the Company and we think our strong capital position gives us the ability to work on those acquisitions and actually be successful in those.

But again, we are going to maintain a disciplined approach on what we are willing to pay as well and what the benefits of the company are. But we are looking at both tuck-in acquisitions and similar lines of business that we are currently in and looking at what our customers are really asking us for and are there products that can complement our existing portfolio that we could ramp up quickly and sell to our existing client base. We are also looking for acquisitions from that perspective and frankly we see opportunities in both right now.

Richard Close - Avondale Partners - Analyst

Great, thank you. Congratulations.

Operator

Dave Windley, Jefferies.

Dave Windley - Jefferies LLC - Analyst

Okay, great. Thanks for taking the questions. Good morning. You have talked in the past about product density differentials between your state contracts and the contracts that you have with some of your commercial client partners. And I wondered if you could as you are giving us some of the commercial cross-selling numbers last year and this quarter, wondering if you could give us an update or some perspective about how those product density gaps might be starting to close?

Bill Lucia - HMS Holdings Corporation - President and CEO

That is a good question. So we look at that closely every quarter. We are still probably -- we slowly inch up on the commercial side, it has historically been six different services in the state market. It has just inched to two or slightly more on the commercial market. But I think one of the things that we didn't necessarily anticipate was that some of the larger customers on the commercial side seem to now be more expanded buyers of our services.

I will give you a couple of reasons why I think those factors exist. So if you do look at a two services per customer across 220 health plans, we may have six or seven services across a large national health plan. And I think the reasons that exist is one, they are just a more sophisticated buyer. They have internal resources that do this work but are also, they are looking to redeploy them either to manage margins, a better operating margin or to new initiatives that they are pursuing in their market.

Larger plants we've seen as more sophisticated buyers of our services so reaching out to us more often. And I think the other issue which goes in our favor is the integration of an audit recovery analytics vendor into your existing infrastructure particularly if you manage multiple claims systems is a heavy lift. For us and particularly for payers that have a very large and complex infrastructure, while it may take a little longer initially to set that up, our recurring customers, the ones that are coming to us on a regular basis, that is a real positive.

They don't have really a new implementation, we know how to send claim adjustments back and forth. We are talking to their providers on a regular basis. We are seen as a trusted partner with their data which of course is important to carriers from a security perspective. So I think that two services on an average can at times be misleading but we are seeing a growth particularly across our larger clients.

Jeff Sherman - HMS Holdings Corporation - EVP and CFO

This is Jeff. I would just add as that number increases, we would probably expect as we add more of those products from a revenue perspective there will be probably lower revenues on the incremental products because the core products tend to drive a majority of the revenue.

It wouldn't be a dollar per dollar as we move from two products to three products or four products to five products. I think we would expect probably some lower revenue yield as we increase the number of products sold.

Dave Windley - Jefferies LLC - Analyst

Thanks for that. Jeff, that is close to the follow-up question I was going to ask which is it sounds like the revenue per product, the incremental product is a little bit lower. Is that just that they are buying a product that has somewhat lower revenue value or are these bigger, more sophisticated buyers commanding a more aggressive price from you guys?

Jeff Sherman - HMS Holdings Corporation - EVP and CFO

I think the core products are the ones that are driving the most revenue spend on both sides so as we add incremental products, it is just a function of similar to the state it is going to be less incremental revenue for those additional products.

Dave Windley - Jefferies LLC - Analyst

Okay. On the new services that you are selling to existing clients, the numbers that you are giving this quarter if we look at the full-year numbers I don't think we have exactly the quarter-over-quarter comparisons on your new sales and your up sales in the number of lives that you added. But I am curious about your characterization of the fast start. It seems like the pace is slower than last year albeit last year was helped by the influx of exchange and Medicaid expansion. But I just wanted to get some more color around your enthusiasm for the start to the year in sales when it does look like the pacing is slower than it was last year.

Bill Lucia - HMS Holdings Corporation - President and CEO

Yes, well, I think the challenge in us presenting our sales activity for us is that we talk about closed bookings meaning sign the contract. We don't talk a lot about the sales queue itself and I think that is just being conservative but we've got a significant and growing sales queue since we have restructured, really since we started restructuring the sales approach in the commercial market. And so some of my comments are related to not only the new sales closing so net new lives in Medicaid managed care which is our quicker to market COB services, quicker to implementation, as well as the growing sales queue year-over-year. So some of my comments are related to that.

Jeff Sherman - HMS Holdings Corporation - EVP and CFO

This is Jeff. The only thing I would add is there are different revenue implications from sales on lives so depending on the contract, you've got lives so a certain percentage of those lives will generate revenue and the type of work being done will be different for each contract as well. So there is not necessarily a great correlation between lives and revenue. As we continue to look at our metrics, what we will hope to provide more clarity over time as we can on that but I do think not every lives sales is going to be equal and so you are going to have ebbs and flows in that as well in any particular quarter.

Dave Windley - Jefferies LLC - Analyst

Right, we will look forward to that additional detail. My last question here is around the state guidance which you are keeping the same at flat year-over-year. I guess I heard you describe that the carryover early in this year from lives that added to Medicaid, enrolled in Medicaid late last year seem to be something of a surprise and unexpected. And so I guess I am wondering why that isn't carrying through to a little bit higher full-year guidance? What do you now not expect to get that you previously did?

Jeff Sherman - HMS Holdings Corporation - EVP and CFO

No, I think it wasn't necessarily a surprise. I think it came in a little bit higher than we expected. As I said, it is difficult for us to predict the lag time in any particular state on that. Part of our year-over-year number as well also just reflects changes. We will do incremental or specific projects in states throughout the year that may or may not repeat so that is also a factor as we talk about year-over-year comparisons and we did have some of those in 2014.

So I think we are done with one quarter. As we get through the second quarter, we will look to provide any incremental information but through one quarter we still think state revenue year-over-year being flat is what we expect and again, we did see a big jump particularly in the second half of last year in state revenue. And so the comps will get harder as the year progresses.

Dave Windley - Jefferies LLC - Analyst

Got it. Thank you.

Operator

Elizabeth Blake, Bank of America Merrill Lynch.



Elizabeth Blake - *BofA Merrill Lynch - Analyst*

Hi, good morning, and thanks for taking my questions. First off, I would like to follow up on the program integrity timing issues. I guess could you quantify that impact in any way, maybe a ballpark of the delta between bookings for the quarter and revenue growth for the quarter would be really helpful and when do you expect you will be through that?

Jeff Sherman - *HMS Holdings Corporation - EVP and CFO*

The time lag is going to be different depending on the customer so I wouldn't try to correlate necessarily bookings in a quarter with revenue in that quarter. The time lag from bookings can be anywhere from three to eight or nine months depending on implementation schedules. So I wouldn't necessarily correlate those in any particular quarter.

I think as we have said based upon the sales that have taken place in the back half of last year and the sales activity we are seeing this year, we still feel good that we are going to be able to achieve our commercial growth revenue targets and see growth in the PI side of the business as well.

Elizabeth Blake - *BofA Merrill Lynch - Analyst*

Okay. And then also for the commercial business, several high profile managed care data breaches recently. Are you hearing more about this from your clients and how would you address those concerns?

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

Well, we do get audited by I would say large, medium and small health plans on a monthly basis, not that each plan audits us monthly but I would say at any given time we have 10 information security audits in play. We always pass them. HMS is high trust certified. That is one of the trademarks that we think is important -- go through an extensive process to become high trust certified. I believe it is an important long-term drivers for our industry because we commit significant resources each year to the security of our clients' data, security of the data that we exchange with them, and we just don't think that some of the smaller competitors will be able to maintain that type of infrastructure surveillance activities and the types of things you have to do to be top-notch from a data protection and security perspective. So we think it is long-term a real positive for us and the customers that buy from us.

Elizabeth Blake - *BofA Merrill Lynch - Analyst*

Okay, that is helpful. Thank you.

Operator

Matthew Gilmore, Robert Baird.

Matthew Gilmore - *Robert W. Baird - Analyst*

Good morning. Thanks for taking the questions. Jeff, this is a follow-up to Ryan's question from earlier. I was hoping to get a sense for how we should think about the cadence of margin improvement as the year progresses. Will this look similar to last year where 2Q saw meaningful step up or should we think about a more ratable increase through the balance of the year?

Jeff Sherman - *HMS Holdings Corporation - EVP and CFO*

We haven't given specific margin guidance throughout the year but we do expect revenue to increase throughout the year and some of the margin performance will be contingent on some of the items which are hard to predict such as our legal costs. But I think we are expecting revenue to ramp up throughout the year and so I would expect we would see some leverage on that as the year progresses from a margin perspective.

Matthew Gilmore - *Robert W. Baird - Analyst*

Okay, thanks. And then one more quick one regarding the hospital settlement with CMS last year, I thought there was some possibility the settlement could impact RAC fees for the settled claims. Has there been any update on this issue from CMS?

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

Yes, Matt. So we have been in ongoing discussions with CMS regarding the issue of how they are going to handle the RAC fees associated with the case. Of course those communications and conversations are confidential. CMS has not given us a final accounting of which provider claims they settled that were associated with HMS findings that were appealed. So the first item for us is just getting an accounting of the appeals that HMS has worked on that have been settled and we are still waiting to get that from CMS.

Matthew Gilmore - *Robert W. Baird - Analyst*

Okay, thanks very much.

Operator

Frank Sparacino, First Analysis.

Frank Sparacino - *First Analysis Securities - Analyst*

Just one real quick for me. Curious, Bill, I know in some of the states like New York that are going through MMIS re-procurement process, I am just curious, do those have any real impact in terms of HMS winning the business or and just implementation process?

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

Frank, an MMIS implementation or conversion typically doesn't impact procurement. In fact, the states are pretty incented to make sure they do a good procurement, they pick the right vendor on the COB or TPL side because that is a constant stream of cost recoveries and prospective savings for them.

The actual conversion to a new system and this is I would say across the board something we deal with in our business every day whether it is an MMIS system or at a large health plan, a claim system conversion, we work with that throughout the year. We call them re-implementations because we are really working with new claim formats, new inputs and outputs to their system. So on a par, on an average, we probably deal with I don't know, I would say at least half a dozen of them a year and we just factor that into our forecast.

But I think net net, it is a positive because we have been very responsive to states in the integration side and of course we have worked with every MMIS system that is in the market integrated to them on the front-end and the back-end.



Operator

That was our last question. I would like to turn the call back over to our host.

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

Thank you everyone. Just a reminder that a replay of the call will be posted later today. Have a good day.

Operator

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

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