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HMSY - HMS Holdings Corp at JPMorgan Healthcare Conference

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PRESENTATION

Anthony Husni Makdessi - *JP Morgan Chase & Co, Research Division - Research Analyst*

This morning, it is my pleasure to present HMS Holdings Corporation. They were founded in 1974 and based in Irving, Texas. The company offers cost-containment services to health care payers and sponsors, including the coordination of benefit services and program integrity services. Both services aim to ensure that health care claims are paid correctly. Customers of the company involve both government individuals like state Medicaid agencies, CMS, pharmacy benefit managers and the Veterans Health Administration. Presenting today is Chairman, President and CEO, Bill Lucia. And with that, I will give the floor to him.

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

All right. Thank you, Anthony. Now I should get an extra minute because you took a minute off my clock there. Good morning, and thank you for attending our presentation today.

Yes. This is a little sticky. So it's not -- it wasn't just Michael [might or fit] had the problem. We need a little AV help here. Now I get an extra minute. All right. These disclaimers are important, but being a health care cost containment company, we're also letting you not take any Ambien tonight. And now you can take this page home and read it to help you sleep better.

So today, I'm really going to provide a brief overview of HMS for those really not familiar with the company and our business. We'll primarily focus on key assets, our growth drivers, the consumer engagement business we acquired last April, and we'll close with a review of our strategic priorities for 2018.

We do have 3 primary product lines as a company: Medicaid Coordination of Benefits or COB, which is our heritage business and last year represented about 70% of our revenue. And this product seeks to ensure -- assure that the right payer pays the claim. Payment Integrity, which uses advanced analytics to identify and recover claims that were paid in error for a multitude of reasons, clinical coding or provider contracting issues or other payment errors that are uncovered from our data mining. And our newest line of business, which is care management and consumer engagement analytics and services, focusing on assuring that patients are more actively engaged in their care and that our clients have the tools to manage high-risk members.

So I'll go into the products in a little more detail later, but in essence, these products create a one-stop shop, comprehensive solution for health care payers and other at-risk entities. And they do represent a very diverse revenue base from which HMS can grow.

Now we've traditionally defined our addressable market as the payment errors in the system in the U.S., which are estimated to be between \$180 billion to \$200 billion a year. That's pretty large. But with the addition of Eliza and Essette, our opportunity to tackle waste and inefficiency has expanded exponentially to address the estimated \$1 trillion of waste and inefficiencies in our health care system. And so we'll spend some more time this morning talking about how we'll do just that.

We'll review our key assets, which we believe are the massive data that we store in-house, the analytics that we apply to that data to generate financial results for our customers, our very large growing and diverse customer base and all of that in-house expertise that's so necessary to put all of this together.



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We do have massive data stores. We believe we have the largest insurance coverage and eligibility database in the nation, regularly receiving feeds from over 1,200 different entities daily, weekly or monthly. This allows us to deliver best-in-class COB services to managed -- Medicaid-managed care plans and state agencies. Our warehouse also includes coverage information for over \$300 million unique individuals and more than 90% of the individuals covered by our nation's Medicaid program. So truly, we believe the most comprehensive database reflecting individuals covered by Medicaid and the providers who serve them. And our data stores also include an enormous number of paid claims that our customers provide us on a regular basis, upwards to about 3 billion claims annually.

We have developed over time and deploy very sophisticated proprietary matching logic, and that continually is improved, and it's been improved over the last 3 decades to support our COB products. Our predictive algorithms and custom analytics drive the integration or the identification of significant overpayments in our Payment Integrity business, and our provider- and member-level analytics help us identify fraud, waste and abuse and also to deliver the most sophisticated consumer engagement campaigns in the health care industry.

I think our large and diverse customer base is perhaps the most significant differentiator from our peers. We serve over 300 health plans, including 23 of the top 25. They're Medicaid MCOs, Medicare Advantage plans and true commercial plans, both at-risk and administrative service, or ASO, plans.

Our business originated serving state Medicaid agencies, and we now service -- serve over 40 state Medicaid programs. Many we have served for more than 20 years. We have federal contracts with CMS, the Centers for Disease Control and the Veterans Administration. And with the development of our care management and consumer engagement solutions, we now serve other at-risk entities such as risk-bearing providers, PBMs, hospital systems, ACOs and specialty care organizations.

Each year, we work directly with hundreds of employers, primarily delivering dependent-eligibility audits and also with benefit advisory firms to sell our full range of services to self-insured employers.

Now this provides HMS a very large and diversified base to sell into, and no single customer represents 10% or more of our revenue. So no consumer -- customer concentration risk at HMS, which is pretty rare in our space. And finally, 80% of our sales come from selling new services to existing customers. So a critical asset to us.

We do have significant credentialed in-house experts. More than 1,000 data analysts, data scientists, behavioral scientists, engineers, security experts that serve our customers day in, day out. In addition, we have over 350 clinicians on staff, including doctors, nurses and medical record coders, who assist on the clinical side of our business, both in the review of Payment Integrity claims and in building consumer engagement campaigns in our new business that we acquired, Eliza.

And I think very important from a competitive perspective, HMS is HITRUST certified, and that is the health insurance industry's gold standard for being a good steward of protecting personal health information. This will soon become stake -- table stakes as a requirement for doing business with some of the nation's largest health plans. And in 2017 alone, we received many awards and recognitions for both our technology and security platforms and programs.

Now there are 4 principal tailwinds really that are helping grow HMS, but let's start with the very favorable macro environment in which we operate. The costs of our health care system keeps rising because our nation has an aging population with high-cost chronic conditions. Medicare alone is projected to grow 28% in enrollment and 88% in spending by 2025, with about 10,000 people a day joining the program, most of them enrolling in Medicare Advantage plans, which, of course, benefits our growing commercial business.

Medicaid expenditures are projected to grow 64% over the same period. And of course, claim payment error rates still hover around 10%. Yes, that means, that 1 in every 10 claims is paid in error. And the entire health care industry is focused more and more on engaging the consumer to be a more active manager of their health. So whether you're health plan, an integrated delivery network or a provider, changing patient behavior is critical to improving outcomes, which does ultimately lower costs.



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And with 5% of our nation consuming about 50% of our health care costs, we think there's a significant opportunity for HMS to impact the system in a meaningful way.

So now let's move on to our products. First is our heritage business, Medicaid Coordination of Benefits. Really it's where we cut our teeth. And it's the business that has a significant and deep competitive moat around it. No other company has similar experience, the data matching algorithms, extensive insurance database, as I mentioned before, with 300 million unique lives. And most importantly, no one has come close to achieving the financial results we generate for our customers.

Our COB business is encased by federal law that mandates that Medicaid is the payer of last resort. So if someone on Medicaid has other insurance, typically, it's employer-sponsored insurance, that coverage should always pay first. Medicaid is an income-based benefit, and there is a lot of churn on and off the Medicaid programs and on and off employer insurance -- employer-sponsored insurance. And this churn actually generates more opportunity for HMS as we help our Medicaid clients assure they only pay the claims they're responsible for paying.

We recover over \$1 billion a year for state Medicaid agencies and Medicaid Managed Care plans. And they say they save 4 to 6x that amount using our perspective services in COB. And typically, our clients enjoy a 10 to 15:1 return on investment, and HMS is not paid until we deliver results.

Now we're newer at Payment Integrity, and it is an area for increased focus for HMS in 2018 and going forward. This service, compared to COB, which looks for the right payer, this service looks at all of the claims and sees which claims are paid in error. So we're continually enhancing the sophisticated algorithms and data mining techniques that we use to identify claim payment errors and recover those dollars from providers of service.

As a company, we're focusing on shortening our implementation times for this high-demand service from sales to revenue generation. And this past year, we've used artificial intelligence, natural language processing as well as robotic process automation to double the productivity of the nurses and coders who were reviewing the claims. And we expect to see the results from all of those efforts early in 2018.

And what's probably most exciting is our new vertical, care management and consumer engagement, which was created via the acquisitions over the past 15 months of Essette and Eliza. Our health engagement program is a tailored, targeted and integrated platform of consumer outreach and engagement from segmentation of populations all the way down to the individual member. This business leverages our data and analytics to produce population risk intelligence, and our services help our clients better manage costs, clinical outcomes and improve their member experience.

These service areas also provide for revenue diversification for HMS. We deploy more of a recurring revenue or SaaS-based model in this business versus our historical contingency fee model or success fee pricing we use in COB and PI. And just this morning, we announced 2 new executive hires that just continue to bolster our focus on these growth opportunities which we've discussed for some time now, an executive to lead our commercial market, which includes health plans, TPAs and employers, and an executive to drive our care management business and consumer engagement product lines and both highly pedigreed executives hitting the ground running for these high-growth areas for HMS.

So let's consider some statistics where member awareness and intervention could help improve outcomes. 29 million Americans have diabetes, 1/4 of whom don't know it. An additional 86 million are prediabetic, and only 10% are aware of that. 20% of the Medicaid population have behavioral health issues, which impact their physical health if it's not managed. 1/3 of Americans are obese, and almost 10% of all births in 2016 were preterm. We can impact these outcomes for these individuals with our consumer engagement services.

Our sophisticated and patented technology deploys behavioral science, third-party data and patient demographics to develop communication programs, campaigns that are targeted at the individual consumer. We can determine which modality of outreach a member will actually respond to and engage, whether it's a text, e-mail, interactive voice response or they need a live agent call. In essence, we've developed a platform for personalized, member-centric engagement, but at scale. We also assess and integrate social determinants of health because concerns about basic life necessities such as housing, food, safety impact productivity and do impact health outcomes. Armed with this information and the services that HMS Eliza delivers, health plans can direct members to helpful resources such as medical transportation, job placement and behavioral health services, all to ultimately better control the cost of care.



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I do want to also tell a story about the speed in which we can deliver value. During the recent hurricane season, 2 of our clients asked us to engage with their members who resided in the mandatory evacuation zones to inform them that they were approved for early refills for life-sustaining medication such as antiseizure meds and diabetic supplies. We performed the analysis, the segmentation of the population and completed the entire outreach campaign within 24 to 48 hours. So pretty amazing results, and the members were pleased that their health plans were actually worried about them. This is the power of the tools that have been built and we will continue to be more widely deployed by our growing health plan client base.

Now we're going to focus on 2018, and I'd like to discuss our plans for margin expansion, capital deployment and the strategic focus of the company. We'll actually be giving our 2018 guidance in our February earnings call, where we'll also be discussing our full year financial results.

So HMS does have a scalable business model. And what that means is, each dollar of incremental revenue is contributing higher than the company's average operating margin. And we are continuing in 2018 to invest in our Big Data solutions, artificial intelligence, robotic process automation and natural language processing, all with the effect of raising yield from our products and lowering our per unit cost to the company.

We do also expect a margin increase by the growing percentage of subscription revenue that we'll be getting through our new SaaS-based solutions, both in our care management software and our member engagement software.

HMS as a company generates strong cash flows from operations year in and year out. We will continue to invest in growth, and we will complete the integration of the Eliza business as our very first priority. It's been going well. We have expanded the sales force, and we're selling into the very large customer base that HMS has today of over 300 health plans. We will continue to be acquisitive to accelerate our growth as our customers continue to look at reducing the number of vendor partners they choose to work with. Remember, they need to make sure their data is secure. And HMS is currently a formidable player in the space and a likely consolidator. We do have a \$50 million share repurchase authority in place, which we will use opportunistically. And finally, last month, we did announce a new amended credit facility adding flexibility for us but do expect to continue to maintain a conservatively levered balance sheet.

So the broad strategic themes for 2018 are to accelerate our organic revenue growth with a particular focus on Payment Integrity and care management and our consumer engagement services. We'll continue to invest in and expand the use of Big Data in order to leverage this rich asset that we have, and we'll implement advanced technologies to further drive efficiencies. We're maintaining our laser focus on customer satisfaction, where we have consistently scored in the top box, employee engagement, which has been improving each and every year and total shareholder return.

So let's summarize where we're headed as a company. Our payer clients are more focused now than ever on the interactions with consumers, realizing that engaged and satisfied customers lead to lower medical cost, higher government program reimbursement and better member retention rates, all impacting their bottom line. Health plans, traditionally, their clients were the large employers or the benefit advisories firms or government or maybe the providers, but all are realizing that the focus on the consumer is one of the ways they're going to bend the cost curve. So our latest acquisition really allows us to help them do that and at scale.

Adding this new vertical which provides our customers with tools to effectively engage and manage the health of their members, utilizing our data or their data which we have already warehoused. So we can go to perspective customers who are clients of HMS today and present the type of results we can achieve with consumer engagement services because we already have their data. Our new care management and consumer engagement platforms really broaden our focus beyond payment errors, and it substantially expands our addressable market, enhancing the stickiness of our customer relationships and diversifying our revenue base.

And the bottom line, HMS continues to be one of the few companies that really can help bend the ever-rising cost curve in our nation's health care system. And this chart shows what we're faced with as we enter 2018 with a great deal of enthusiasm about our new ability to execute on this much broader strategy and to grow profitably and boost returns for all of our stakeholders. You'll hear more about our full year financial results on our February call. We hope to close the year strong and look forward to a -- giving you guidance on that call. Thanks for attending our presentation today.



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