



Q1 2011 Conference Call
May 4, 2011 - 5:00 pm ET

Robert Borchert - MedAssets, Inc. - SVP, Investor and Corporate Communications

Thank you, Casey, and good afternoon. We will be making forward-looking statements on today's conference call regarding MedAssets expected financial and operating performance, which may be affected by risk factors that are described in detail in our periodic filings with the Securities and Exchange Commission.

There are also risk factors not presently known to us, or which we consider to be immaterial, that may also adversely impact our performance. Therefore, actual results may differ materially from our forward-looking statements discussed today or in the future. MedAssets assumes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events, or otherwise.

Today we'll also discuss certain non-GAAP financial measures. Please refer to the reconciliation schedules and footnotes in today's earnings press release, which is posted in the Investor Relations section of our corporate website, Medassets.com, for more information on these non-GAAP measures.

Leading the call for us today are John Bardis, our Chairman, President, and CEO and Chuck Garner, our Executive Vice President and Chief Financial Officer. Rand Ballard, our COO and Chief Customer Officer, is also on the line for the Q&A session.

Now, I'd like to turn the call over to John Bardis....

John Bardis - MedAssets, Inc. - Chairman, President and CEO

Thank you, Robert, and good afternoon everyone. We posted solid first quarter financial results, delivering net revenue of approximately \$136 million, adjusted EBITDA of \$41 million and cash EPS of \$0.17 per share. Importantly we are on track to achieve our guided outlook of approximately \$57 million in after-tax cash net income for the year. Chuck will provide more details on the drivers of this performance in a few minutes, but right now I'd like to comment on three primary topics as we remain focused on executing on our 2011 operating plan.

First, the actions we've taken to position our Revenue Cycle Services business for sustainability and future growth. Second, our initiatives to maintain the growth trajectory for our Revenue Cycle Technology business. And third, our focus on extending our leadership in Spend and Clinical Resource Management as a financial and performance improvement partner for healthcare providers.

Under Greg Strobel's leadership as President of Revenue Cycle Services, a full business review was completed in the first quarter and a number of key initiatives are underway to improve our operational execution and to drive toward more profitable revenue growth. We have enhanced our approach to measure customer satisfaction and key success criteria for our customers. For example, we have implemented an improved quarterly review process with customers to gain mutual agreement on progress to date as well as weekly monitoring of key performance indicators to highlight customer success, proactively identify potential customer concerns, and to monitor staff productivity and quality.

We are moving to centralize certain functions in order to improve standardization and create greater efficiencies and scalability. In addition, we are refining our incentive compensation model for revenue cycle services employees to improve alignment with our customers' productivity, cash collection and quality goals.

We have also improved our internal training processes to ensure that our services experts are fully utilizing MedAssets core revenue cycle technology tools at maximum efficiency and to provide valuable feedback for future product enhancements. We are pleased with the efforts to date and look forward to having our customers benefit from the results of these endeavors.

While we've tempered our near-term growth expectations for this business, we do expect to sign and announce new outsource services agreements as we move through 2011, based on the market's interest in our integrated technology and service solutions.

At the same time, Neil Hunn and his team are focused on maintaining a solid growth trajectory for our Revenue Cycle Technology business. As we noted last quarter, we are ramping up the deployment of our charge integrity suite and associated consulting services for Ascension Health. Go live dates are planned at more than 65 acute care locations in 2011 and 2012, as we work with Ascension to standardize their charge and cost data across the health system to improve revenue integrity and drive best practices.

In addition, as part of our ongoing commitment to deliver innovative and integrated revenue cycle management solutions, this year we are launching two major new product offerings. On the front end, we will deliver an access management platform that offers an integrated workflow and reporting capability that improves the accuracy of patient financial information to secure upfront payment. At the backend of the revenue cycle, we will launch a next generation collections management solution. This integrates our claims, contract, and denial management reporting tools with a collection workstation that enables health systems to optimize accounts receivable management with business rules to drive greater productivity and financial performance.

Both solutions were soft launched at our Healthcare Business Summit last week. We anticipate general availability in the third quarter of this year as we build momentum heading into 2012. We expect to provide more details about these new solutions and expanded market categories at our investor day in August.

I also want to address a question we received last quarter, just to make sure one of our core competitive differentiations in supply chain and clinical management resource management is clearly understood. As you will recall, a major medical device supplier cancelled a number of physician preference implant contracts with some of our competitors earlier this year. This is not a surprise to us because it actually validates MedAssets' business strategy and distinctive approach to dealing with high cost implantable medical devices.

National GPO contracting is not always the most effective strategy when it comes to helping healthcare providers source and control PPI costs, particularly where there is strong physician clinical preference. This is why MedAssets offers customer specific PPI sourcing and analytics expertise to engage physicians in the value analysis process and develop the best strategies for improving cost and value in clinical resource utilization.

MedAssets does have a small number of group purchasing contracts for PPI that deliver meaningful value to providers. We would expect to maintain national GPO contracts for select PPI categories, but only if we know the agreements can deliver significant value for both our customers in terms of specific quantifiable savings and PPI suppliers who gain committed purchasing volume through high compliance to our GPO agreements.

This dual approach helps our customers leverage either a national GPO contract, if it can deliver the best savings, or a custom contract meaning an analytics expertise to better manage certain PPI categories on a local basis.

As we noted last quarter, we are on track to achieve an annualized run rate of \$20 million to \$22 million in targeted cost synergies related to the integration of Broadlane and MedAssets. Our teams are now wholly focused on executing on revenue synergy opportunities. We're making progress on a number of fronts and you should expect to see additional agreements similar to our renewed and expanded contact with Advocate Health that was announced today. Our aggregate sales pipeline supports our outlook for the year with particular strength in our spend and clinical resource management segment.

We remain committed to executing on our financial and operating plan as we work to sign new business, achieve our performances and guarantees, and deliver on our value proposition by retaining and renewing customer contracts.

With that, let me ask Chuck to review our first quarter results and offer some additional insight into our updated 2011 outlook. Chuck?

Chuck Garner - MedAssets, Inc. - CFO and President, Revenue Cycle Technology

Thank you, John. I've had the pleasure to speak with close to 200 investors and analysts since the early part of this year as I transitioned into the CFO role on April 1st. We fully understand that you are looking for our management team to deliver consistent operating and financial performance as well as clarity and directness around business issues or variances. And that is what we will be focused on over the coming months and quarters.

Most of my commentary today will compare a recent quarterly performance with the acquisition affected and recast results from the first quarter of 2010 for an appropriate apples-to-apples comparison. So please refer to our reconciliation schedules in today's press release and our historical acquisition affected and recast results on our website for additional details.

As it relates to our first quarter performance, on a consolidated basis, including the \$5.6 million purchase accounting revenue adjustment related to GPO administrative fees, our total net revenue was \$136.1 million, essentially flat with the first quarter of 2010 on a acquisition affected basis.

Revenue in our Spend and Clinical Resource Management segment grew 1.1% to \$84.9 million, which was in line with our expectations as our GPO related net administrative fees grew 6.3%. Other Service Fees, which comprised approximately 27% of first quarter segment net revenue, decreased 10% due primarily to lower decision support services revenue, consistent results from our medical device and clinical consulting capabilities and lower outsourced services revenue as we deferred certain revenue to future periods. Excluding decision support services from both periods, other services fee revenue in the segment declined 4.7%.

As we turn to our Revenue Cycle Management segment, revenue decreased 1.3% to \$51.2 million as expected. As we discussed last quarter, a few of our large revenue cycle services customers are completing their transition from transformational services engagements, which generated higher short-term revenue, to the revenue cycle technology-only phase of their contracts. There was also approximately \$4 million in revenue in the first quarter of 2010 from our former Cook County contract that did not recur this year.

While services comprised approximately 30% of first quarter RCM segment revenue, and was down approximately 21% from the first quarter a year ago, our revenue cycle technology business maintained a solid trend and grew approximately 9.7% year-over-year.

Our businesses delivered consolidated adjusted EBITDA of \$40.9 million or a margin of 30.1%. This was slightly better than expectations due to operating expense controls and slightly higher than forecast purchase accounting revenue adjustments or GPO administrative fees.

During the quarter, third-party evaluation studies were completed that related to our customer relationship period and useful life of internally developed software. As a result, we moved our customer relationship period from four to six years and our internally developed software life from three to five years.

Our effective income tax rate in the first quarter was 33.6% due to a pre-tax book loss. We expect our effective tax rate to be in the 35% range through 2011 until we report pre-tax income. We will continue to tax our cash EPS add backs at a 40% rate since we believe that will be our normalized long-term tax rate.

We reported a GAAP loss of \$16.2 million, or \$0.28 loss per share, and our cash EPS came in at \$0.17 per share.

Our March 31st balance sheet reflects about \$901 million in total bank and bond debt, net of cash, which is 5.3 times our trailing acquisition affected adjusted EBITDA. In early April, we voluntarily repaid \$25 million of our \$635 million term loan. We anticipate using our free cash flow in 2011 and undrawn revolving credit facility to repay the \$125 million deferred payment related to the Broadlane acquisition on or before January 4th of 2012. Then we expect to begin using our available free cash flow to aggressively delever by repaying our term loan and revolver.

One note on our quarterly cash flow. We pay our revenue share obligations to certain hospital and health system customers primarily in the first and third quarters of each calendar year. So we anticipate our free cash flow to be higher in the second and fourth quarters, which is consistent with previous years.

During the first quarter, we capitalized approximately 44% of our software development costs, consistent again with our annualized capitalization rates for the past three years. At March 31st, our day sales outstanding were 61 days, down three days on a sequential basis from year 2010 as we fully integrated the Broadlane revenue base and collected accounts receivable related to our acquisition related purchase accounting revenue adjustment.

Our bad debt expense was 0.28%, a first quarter other service fee revenue as we continue to work with our customers to mitigate potential receivables exposure.

Now turning to our outlook. We are reiterating our expectations for 2011 as detailed in our press release. We are committed to delivering on this financial growth outlook and remain cautiously optimistic at this early part of the year. While we do need to sign a number of new customer agreements according to our projected timing, and are closely monitoring our ability to achieve performance fees and guarantees as well as customer retention and renewals, we have started the year well.

We're in the ramp-up phase with a number of significant new customers, including Ascension Health, Hollywood Presbyterian, and others. We have also had solid execution thus far on the integration of Broadlane. In addition, we expect that we will recognize certain guarantee related revenue in the second half of the year as we deliver on our financial savings targets for customers, including the Texas purchasing coalition.

Even with the significant investments we are making in 2011, we expect our adjusted EBITDA margins to expand approximately 150 basis points over the 2010 acquisition affected margin of 30.3% as we benefit from our Broadlane related cost synergies and fixed cost operating leverage. This will lead to cash EPS growth in the 20% range.

As it relates to our business momentum, our rolling 12-month total contracted revenue estimate increased 1.9% sequentially from the fourth quarter of 2010 as a few sizeable contracts reach a full revenue run rate this year. Contracted revenue for our Spend and Clinical Resource Management business grew 2.6% sequentially, as savings guarantee related revenue from certain spend and clinical resource management customers continue to be added to the estimate.

Contracted revenue in our Revenue Cycle Management segment increased 0.8% on a sequential basis as we continue to transition through a few our large revenue cycle services customer contracts, moving into the technology only phase of the transformational engagement and our signing of smaller outsource services customer contracts.

As it specifically relate to our second quarter, ending June 30th, 2011, we expect net revenue in our spend and clinical resource management segment to grow between 3% and 5% from the second quarter 2010 acquisition affected and recast net revenue of \$86.4 million.

Specific to our Revenue Cycle Management segment, we expect second quarter revenue to increase between 5% and 7% when compared to second quarter 2010 revenue of \$52.5 million. This growth should be driven primarily by additional revenue cycle technology products being put into service as well as the ramp up of certain revenue cycle services customers.

We expect second quarter adjusted EBITDA margins to be in the range of 26% to 28%, down sequentially from the first quarter. This is primarily the result of our annual Healthcare Business Summit, which we anticipate will generate approximately \$5 million in Other Service Fee revenue in our Spend and Clinical Resource Management segment, as well as approximately \$7 million in expenses in the second quarter.

We then expect our second quarter GAAP diluted EPS to be a loss in the range of \$0.15 to \$0.18 per share. When you add back acquisition related intangible amortization and interest expense, as well as a number of other non-cash items, expect to report positive cash earnings per share in the period.

As it relates to our third quarter outlook, we would anticipate consolidated net revenue to increase in the 5% to 7% range versus the acquisition affected revenue of \$140.2 million from the third quarter of last year. And our consolidated adjusted EBITDA margin to expand into the 30% to 32% range.

In closing, we have a very good fundamental business as well as a highly dedicated base of employees, and we are working to improve our operational execution. We believe we are taking the appropriate actions to strengthen our revenue cycle services business and our operations overall. We remain intently focused on signing new business, achieving our performance fees and guarantees, and retaining and renewing customer contracts. Most importantly, we will continue to provide the best financial and performance improvement solutions to help drive success for our healthcare provider partners in the months and in the years ahead.

With that, we would now like to open up the call to questions.

QUESTION AND ANSWER

Ryan Daniels - William Blair - Analyst

One quick housekeeping question up front. As we look at SG&A spend, I think relative to our model is quite a bit higher, but gross margins are also a little bit better than we thought, kind of offsetting one another. Is this a good SG&A rate to consider going forward? Or was there anything unique in the quarter there?

Chuck Garner - MedAssets, Inc - EVP, CFO

Sure. So I think there's a couple things as you look at our press release. You'll notice there was a little bit of movement in some of the line items. So there is some difference between how Broadlane recorded theirs as how MedAssets did, but overall I think it's a pretty consistent expectation if you take the first quarter of 2010 for the rest of the year. Excuse me, '11 rather.

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Ryan Daniels - William Blair - Analyst

'11 right. And then I'm curious, kind of big picture question. Since the ACO regs have been established, are you seeing more interest in some of the service line analytic solutions as providers look to lower the overall spend in hospitals? I know Advocate here in Chicago and you announced a big contract today. They also entered into a similar type agreement with Blue Cross/Blue Shield organization. So is that helping demand for some of your products?

John Bardis - MedAssets, Inc - Chairman, President, CEO

Yes, I believe it is. Service Line Analytics has several hundred installs occurring right now and a backlog pipeline of another several hundred. And I think you're quite correct in the way you're looking at it. I think the whole notion of the ACO is helping drive that need for resource management and analysis, and utilization comparisons amongst individual clinicians.

Ryan Daniels - William Blair - Analyst

And then just on the Broadlane integration. You mentioned that the sales force is, I think you said wholly focused on some of the revenue synergies. Can you maybe give us a little bit of an update there? I know you've talked about cross-selling, greater compliance to some of Broadlane's purchasing programs and the GPO vendors moving to higher administrative fees. Which of those are really panning out maybe most quickly and have the momentum near term? And then what do you see as potential revenue synergies over the next year or two if you've adjusted your thoughts there?

John Bardis - MedAssets, Inc - Chairman, President, CEO

Yes, that's a great question. Let me sort of break the revenue synergy opportunity into two categories if I may. The first, Ryan, would be taking the best of breed of both Broadlane portfolio contracts as well as MedAssets portfolio contracts and identifying where there would be the best revenue opportunity on what we would traditionally call administrative fees. And what we're finding is that where those best administrative fee opportunities are also happen to be where best pricing exists. So it kind of fits our model rather well in the sense that in order to come to a client or a prospective client and offer a new contract or even a different contract for products in the same category, we first and foremost have to deliver value. And so what we're finding is we're able to go to existing clients and show substantial price reductions, and in exchange for that we are planning that we're also able to obtain a better administrative fee.

And so that process is well underway and I think independent of all of other things, it's really energized our sales force as we go back to existing long-term relationships to deliver greater value, which is consistent, if you will, with not only our strategy but with the way our Company's philosophy works with our clients. And so that is going very well. So that's, if you will, the internal cross-contracting opportunity that's inside the group purchasing operations.

The second is on revenue synergy opportunity is going to new clients and offering a broader and deeper portfolio with the combined organizations. And what we're finding is, taking the best of breed for both, that institutions we're going into today we're finding 10% to 20% price improvements for them. And so we're now getting the attention of prospective clients where in the past right out of the box, if you will, off the shelf pricing was not able to do so before.

So we're using the breadth and the depth of our current client footprint as well as the breadth and depth of the existing sales force to offer prospective clients a brand new set of solutions with a value proposition that includes substantial price opportunities on current purchase products.

So the internal opportunity for improved administrative fees we feel is very strong and our clients are responding well to that. And moreover prospective clients are because of this merger have become very open to reconsidering business opportunities and I believe today our spend management activity and pipeline is as robust as we've ever seen it. And so out of the box, I think the revenue quote synergy opportunity is very favorable.

We are also integrating revenue growth opportunities with existing clients that are historically been Broadlane relationships to include the revenue cycle products, whether that's revenue cycle services from Greg Strobel or revenue cycle technologies in Neil Hunn's group. So we've got a very interesting set of opportunities that are less, if you will, advanced or less mature because it's, if you will, a different set of relationships but in the same institution. So the speed at which spend management has been able to address the opportunities a little bit faster as you might guess.

Ryan Daniels - William Blair - Analyst

Very good color and sounds like a strong outlook. So thanks for that, John.

Donald Hooker - Morgan Stanley - Analyst

Looking at the Revenue Cycle Management segment, obviously you have the services and technology component. How does that break down between services and technology, I guess between Greg Strobel's area and Neil Hunn's area, in terms of that segment? Like 70/30 or something?

Chuck Garner - MedAssets, Inc - EVP, CFO

So the mix of the business, it's approximately 30% services and about 70% technology within in the Revenue Cycle Management segment.

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Donald Hooker - Morgan Stanley - Analyst

And just an update on the technology area, which I assume is growing pretty nicely in Neil Hunn's area. When I think of the broader products that you're offering in that space, are there two or three that are kind of leading the charge that are pulling the whole group? Or is it kind of evenly distributed, the demand?

John Bardis - MedAssets, Inc - Chairman, President, CEO

I tell you what, Neil is actually with us here and I'm going to actually ask him to address that question because he's been deeply involved now in rolling out some new products that are very connected to what have been also are strong growers, Don. So if you don't mind I'll turn it over to Neil.

Donald Hooker - Morgan Stanley - Analyst

Okay, thank you.

Neil Hunn - MedAssets, Inc - President, Revenue Cycle Technology

Thanks for the question. So as we said in the past it is a very balanced growth story. We've got a lot of strength in our contract management, a lot of strength in claims management products, a lot of strength in our product that links the revenue cycle to the supply chain. We've seen a lot of strength in our consulting offerings that are product specific to optimize the product and implementations and installs.

And then the two new product categories that Chuck and John outlined earlier in the call around the very front end access integrity and the very back end in collections management. Our new offerings that are very right market opportunities that lean into our strengths of the integration of all of our technology applications that we have. So it is a very balanced growth story. And it's not just one or two products that are sort of pulling the weight for the business.

Donald Hooker - Morgan Stanley - Analyst

Got you, that's great. And then one last one and I'll jump off. And in the revenue cycle services area, can you guys talk about how many of these transformational deals you have on the books right now that you're working through?

Chuck Garner - MedAssets, Inc - EVP, CFO

So in any given time there's about a handful of both transformational and full outsourcing deals.

John Bardis - MedAssets, Inc - Chairman, President, CEO

Don, I think -- let me make sure I clarify your question. I think you might be asking the question on transformation. Is there any more overhang on transformationals that will become smaller over time in terms of the revenue contribution? Or did I misunderstand your question?

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Donald Hooker - Morgan Stanley - Analyst

That wasn't my question, but it sounds like a good one, so that's an interesting question. So.

John Bardis - MedAssets, Inc - Chairman, President, CEO

Don, do you remember in Young Frankenstein when the professor actually stabbed himself in the leg? I think I just did that. I would tell you that our revenue cycle transformational exposure is very limited. We have washed through the grand majority of the risk on the downside or loss of revenue. So I feel pretty good about that.

But and sort of to your question, we are very focused on the outsourced model. And we're finding positive traction from a number of opportunities in the marketplace that we expect to be successful with this year in 2011. So I guess to balance the two, yes I think we've largely bottomed out on those transformational deals that have lost their revenue and transferred to technology relationships. And then moving forward, we think we're going to be playing pretty solid offense on obtaining and implementing just regular outsourced relationships.

Larry Marsh - Barclays Capital - Analyst

So really wanted to follow up, John, on two points. Last week at HBS briefly and I sense a lot of excitement about customers asking for innovation, technology that's going to drive cost savings, empowerment tools allow them to succeed in the new world. And it seemed like the whole business proposition of the GPO about the two models are very resonant.

I guess my question is this. I heard some feedback from people saying well it's the Broadlane people and the MedAssets people, the high compliance and the high flexibility and then Pat pulling that together. Is there going to be a movement going forward where you're going to try to tie all that into one consolidated platform? Has Pat done anything to help communicate that message?

And as we go forward into this year and next, it seems like it should be inevitable that you'll get more of these, I'll call it TPCs of the world that are going to recognize I think the value you guys provide. So question is just branding and coordination under Pat, and then timing of when you expect to see some of that revenue synergies that you talked about.

John Bardis - MedAssets, Inc - Chairman, President, CEO

That's a great question, Larry. Let me first of all sort of dissect that into two categories. One is our highly committed contracting program. That program today represents within, for example Broadlane, 17% of their contracts. Not 17% of their volume, but 17% of their contracts. So even Broadlane remained committed to a highly flexible model because it's very tough to enter a relationship with a client and right off the bat get them completely committed to a fully volume committed program. So as those client

relationships matured for Broadlane they were able to move clients over to those committed volume contracts.

I think you're quite right when you identify the market today as being more willing to go to committed volume contracts where off the shelf pricing is literally as much as 20% to 25% better.

What I would tell you here is that we are now transitioning as we head towards 2014 to the largest change in the history of healthcare delivery. The only thing that compares to it really is the 1965 change to Medicare. And what I mean by that is the entire industry has been incented by cost up to now. While the federal government has clearly since 1983 set its feet on limited cost increases that they'll accept it never stopped the cost incentives being influenced through private insurance the cost generators of new technology and utilization from occurring. That's why the private sector has seen cost increases in healthcare that have been five and six times GDP growth rates.

And so that cost incentive is going to abruptly stop starting in 2014 and this is an entirely new world. And so our providers now are looking at this saying we not only have to reduce our costs, we have to change our processes for the delivery of care. So not only do we have to improve dramatically the prices for those things that we buy, we have to change how we use human resource to drive an outcome and the other resources that are used to actually deliver it. So what we are now seeing is a strong and in fact I would say a demand-pull environment where people are welcoming us to come in and address those issues.

In the longer run, Larry, as you think about the integration of what would be flexible contracting with aggressive committed volume contracting, the key to it is technology. And we've been the technology leader in this space for a long period of time, but our goal is to connect literally a transparent understanding of best price available for products, but also best practice for how clinical resources can be utilized to deploy those products and then compare retrospectively the analysis of how clinical clinicians use those products to deliver an outcome so that the full gamut of what a case and case management process actually cost versus the outcome.

And this is something that's completely foreign to an industry today, which charges in some parts of the country 300% higher prices for the exact same cases based on how their cost infrastructures have been deployed in their accounting systems. And so we're facing a very new day and I think we're seeing strong demand-pull as a result of the recognition of that change.

Larry Marsh - Barclays Capital - Analyst

So just confirming, I mean Pat is still coordinating all that process as he runs that division?

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John Bardis - MedAssets, Inc - Chairman, President, CEO

Pat really for us has been a great guy to do the transition. And that's really what I've asked him to do. He - to be very clear, as great of a solid manager is he's not a technical leader. It's not what he does. We have people who are embedded in the business who are designed to do the contracting work and designed to do the technology work.

The grand majority of what we've asked Pat to do and he's done it brilliantly, is make the integration work, get the cost synergies, and bring the teams together, lead the transition of our offices from two locations to one in Dallas, and that's been largely accomplished.

But technologically speaking and getting into the weeds of what this particular integration is all about is really in the hands of other technically proficient leaders whose job it is based on their supply chain and clinical management expertise to make it happen.

Larry Marsh - Barclays Capital - Analyst

And a quick follow-up, thank you, is the cost of the two RCM product solutions that you're introducing this year. I think they're both in beta test site. Maybe Chuck and Neil, can you quantify how much in expenses those are consuming and exactly when you expect those to be, I guess, GA'd in the marketplace?

Chuck Garner - MedAssets, Inc - EVP, CFO

So I'll let Neil talk about the GA and we don't specifically disclose that level of detail on the investments.

Neil Hunn - MedAssets, Inc - SVP Corporate Development

And Larry, the GA dates we expect that they will launch the products at our big conference, the industry conference in the second quarter. And they'll be generally available for implementation early in the third quarter.

Larry Marsh - Barclays Capital - Analyst

Both at the same time?

Neil Hunn - MedAssets, Inc - President, Revenue Cycle Technology

Yes, they're both on the same schedule.

Constantine Davides - JMP Securities - Analyst

A couple quick ones here, guys. On the revenue share obligation that looks like the highest figure we've seen in a while and I'm just wondering if you can give us a little bit more color there and what we should expect across the balance of 2011.

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Chuck Garner - MedAssets, Inc - EVP, CFO

The short answer is it largely has to do with the mix between Broadlane and its revenue share obligation and then combined and blended with MedAssets. So we expect what you're seeing for the first quarter to be indicative as we go through the rest of the year.

Constantine Davides - JMP Securities - Analyst

Will it be as volatile as we've seen in previous years in terms of sort of jumping around from quarter to quarter?

Chuck Garner - MedAssets, Inc - EVP, CFO

No, I wouldn't expect a significant amount of volatility. I think that the jump you may be looking at on a year-over-year basis has to do with more of a mix between Broadlane versus MedAssets standalone.

Constantine Davides - JMP Securities - Analyst

And then I apologize if I missed this, but did you guys provide a cash EPS number? It looks like the Street has a pretty wide range for the second quarter.

Chuck Garner - MedAssets, Inc - EVP, CFO

No, we do not.

Constantine Davides - JMP Securities - Analyst

Directionally is that going to be up or down from first quarter?

Chuck Garner - MedAssets, Inc - EVP, CFO

Yes, in general I think we're consistent in reconfirming our guidance and outlook for the year.

Jamie Stockton - Morgan Keegan - Analyst

I think the first one, John, in your prepared comments you alluded to the fact that you would continue to retain some GPO contracts on PPI items. Should we be reading into that that you think that Broadlane's GPO contracts on those types of items are going to largely remain intact going forward?

John Bardis - MedAssets, Inc - Chairman, President, CEO

Jamie, that's a good question. I think so. Let me explain why. There is, as you probably saw with Senator Max Baucus recently, there's a tremendous amount of pressure being applied on the Class III medical devices that are implantable and for a variety of reasons right now. But in particular, Senator Baucus is focused on the issue of price transparency. And so many of these particular products are sold to hospitals directly with agreements that suggest that even if a Medicare patient or a Medicaid patient uses them and

it's paid with federal funding that the prices for those products remain a trade secret and may not be shared.

I think the physician preference implant marketplace is going through a fairly dramatic change. And that change will influence I believe the process for contracting. And so as you know, MedAssets has been very successful historically in managing the clinical and physician preference implant contracting process on a local level by engaging docs locally.

Broadlane has had some reasonable success with certain physician preference implant products under contract at a national level where they could achieve clinical commitment from individual integrated delivery networks. I believe that the hybrid of those two options will remain intact for some period of time, but over time as these markets become more homogenized with truly transparent data, we will probably see in the future, and I can't tell you that it's going to be in a year or two years, but I think there will be more national agreements for Class III medical devices.

In the meantime, there's going to be a lot of moving parts. I think that we're pretty well positioned with national contracts that are effective in certain categories where particularly the medium and smaller size institutions are prepared to make commitments. We are still able to achieve fairly dramatic price savings, using our technology and our clinical resulting interface with Aspen Healthcare Metrics and I don't see that changing either. And but I do see the political and policy landscape getting a lot of attention on this subject.

Jamie Stockton - Morgan Keegan - Analyst

I appreciate that. Following up on something that Ryan asked and maybe getting a little more granular. For the revenue synergy between putting your original GPO together with Broadlane, one of the areas that is interesting to me is the procurement outsourcing that Broadlane's historically done for I think the majority of their spend base. Is that something that you're seeing any traction within the MedAssets GPO base looking at that service?

John Bardis - MedAssets, Inc - Chairman, President, CEO

That's a great question, Jamie. We are having a lot of meaningful conversations right now about that and I think what you're speaking of are really two particular products and services that the Broadlane team have done I think a brilliant job in building. One is their national procurement center in which hospitals can turn over their entire order processing and order management and contract management requirements to Broadlane and they do that on a centralized basis in the Dallas office.

And then another is for those institutions or groups of institutions and IDNs that want someone to come in and onsite be the actual outsourced, if you will, or partner manager of the business process.

I think both of those services in an environment that is going to be extraordinarily cost constrained and where resource allocation and management for those services have been widely variant in terms of their actual costs internal to hospitals, as they exist today. I think we're going to be seeing many more hospitals look to get a consistent and low-cost option for consistent performance in both the outsource space and simply the national procurement space. So that people who are in material management roles in those hospitals are not using their precious time and resources to actually place orders and manage the order process. So, short answer is we're seeing some very interesting traction inside the existing MedAssets client base.

Stephen Shankman - UBS - Analyst

On the last call I think you called out about three of the largest 25 SCM contracts were up for renewal this year. Just wondering what the status of those renewals were and if Advocate was one of them?

Chuck Garner - MedAssets, Inc - EVP, CFO

So as far as the status, there are several that are still going on discussion. I believe there's two of the three that are still ongoing discussions for renewal. We don't comment specifically regarding individual names.

Stephen Shankman - UBS - Analyst

And then I guess as a follow-up there, regarding the remaining 22 largest SCM contracts, how do they roll off over the next couple of years? Just trying to get a sense of the timing of those.

Chuck Garner - MedAssets, Inc - EVP, CFO

The contracts in general tend to be around three- to five-year lives in general, so you can expect that they would roll-off periodically across that period of timeframe over the next three to five years.

Stephen Shankman - UBS - Analyst

I guess just changing directions real quickly. Maybe I missed this, but can you update us as to whether you received any of the, I guess 2010 delayed performance fees so far in 2011? Or when you might expect to receive them?

Chuck Garner - MedAssets, Inc - EVP, CFO

So I don't think we have an update at this point for any additional delayed performance fees from 2010 in terms of receipt.

Stephen Shankman - UBS - Analyst

Do you still expect to receive them in 2011? Some of them?

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Chuck Garner - MedAssets, Inc - EVP, CFO

I believe, and I'll look back at their -- our prior remarks, but I believe you're talking about approximately a \$2 million amount that we discussed previously, some of which we said we thought we'd be able to receive in the future and some of which probably would not be able to be recaptured. I think a meaningful piece of that we will not recapture. There was a portion of that that still is remaining outstanding.

John Bardis - MedAssets, Inc - Chairman, President, CEO

Yes, there's one specific client that we're talking to right now on that performance fee that was the bulk of what was our best opportunity. And we are in the final phases of working that out. But it's a good question. It's not a large number.

Michael Cherny - Deutsche Bank - Analyst

Just a quick housekeeping question. I was looking at the EBITDA reconciliation, EPS reconciliation. Any reason for the change in the share based compensation expectations for the year?

Chuck Garner - MedAssets, Inc - EVP, CFO

So Michael I'll have to look at that a little bit more closely. As I recall though it wasn't a substantial change. I think it had to do primarily with forfeitures. But let me confirm that and I'll follow up with you.

Michael Cherny - Deutsche Bank - Analyst

That's helpful. And then just kind of digging a little bit more into the product line as well, I know you talked about the deal win earlier today, the addition of Service Line Analytics. Can you talk a little bit, just kind of breaking that product out about kind of -- I think we're about a year and a half past the initial launch of it or something like that. Kind of how the success has been on that product specifically in terms of customer feedback and what they liked about it?

John Bardis - MedAssets, Inc - Chairman, President, CEO

Michael, John Bardis. Thanks for the question. What we're finding is that the product is doing, and I'll get to the specifics of that in a moment, the product is doing what we have built it to do. Which is analyze complete service lines within institutions. And I'll give you an example.

Let's talk about the orthopedic service for hospitals, which historically 15 years ago was a very profitable business in the surgical suite. And now across the nation is about a negative 3% for the average hospital largely driven by the cost of medical implants.

But as part of doing the analysis to determine how those costs are driven, there are a number of things that have to be looked at. For example, OR cut times. In many cases certain technologies have been sold to physicians under the belief that the technologies are creating more efficient care process. And so when we

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look at OR cut times and recovery times, and for example, the kinds of antibiotics that are used, or in a very similar case antibiotic bone cement, are those necessary when we measure infection rates in those patients that have the products used on them or not?

So it's the entire gambit of clinical resource utilization measurement in relationship to payment that allows for comparative analysis to be done, not only by service lines, but literally from clinician to clinician, and then to be able to compare that to payment. The product is, in fact, doing that analysis and delivering actionable information to institutions so that it helps them identify where the first best opportunities are for cost reductions, which include, for example, improvements in length of stay, as well as the cost of specific products and reimbursement.

Chuck Garner - MedAssets, Inc - EVP, CFO

Michael, just to follow up, I did want to confirm you the change had to do with forfeitures being higher than expected originally forecast for the period.

George Hill - Citi - Analyst

I didn't know my name had gotten changed, but I appreciate you guys taking the question. I'll say Chuck, just a quick housekeeping item first. Did you say the loss of Cook was worth \$4 million on an annual run rate basis?

Chuck Garner - MedAssets, Inc - EVP, CFO

Yes, approximately \$4 million, for the first quarter for a year ago.

George Hill - Citi - Analyst

And then just, I guess as we look through the first quarter and out for the rest of the year, I guess can you detail whether or not there's much more exposure to the qualitative performance based metrics that were a little problematic in Q4? And how should we be thinking about that for the rest of the year?

Chuck Garner - MedAssets, Inc - EVP, CFO

Yes, I think two points to start off with here, and I'll let John add any additional comments. So I want to be clear that there really aren't a lot of qualitative components in our contracts. And we can spend some more time talking about that.

But we don't feel that there's an issue with our contracts. We feel comfortable the contracts and the language we have in place is related to any sort of performance or guarantee related revenue. And as far as the level of exposure, we don't feel that there's a substantial level of exposure. I think moreover as John mentioned in his opening remarks, the focus has been on ensuring we've very much tightened up the operation and the execution discipline around those types of relationships. And so we feel good given

where we are knowing that not everything is fully within our control. But feel good with the outlook on those types of arrangements.

John Bardis - MedAssets, Inc - Chairman, President, CEO

Yes, and George, one of -- the example that you're citing was a specific client that we had that does a lot of business with MedAssets that while we had technically achieved our objectives, there were some qualitative performance measures that they felt we hadn't hit. And we've largely sorted through that, but it did affect our financial performance last year, certainly in the fourth quarter.

We do have substantial performance bonuses and revenues that are due us. Perhaps the most compelling of which is Texas Purchasing Coalition, formerly the VHA of Texas. And the only thing I'll say there is we're very close to the situation and I personally spoke to the CEO recently and he has confirmed that what our belief is and that we are well on track, in fact overachieving the expectations to receive our performance bonuses this year. So I feel that the exposures we've had historically are largely behind us.

George Hill - Citi - Analyst

That's great to hear. And maybe one more just quick one, John. As you're talking to hospital customers now, because in the hospital space medical necessity has recently become a high profile piece of functionality that's offered, has that situation led to MedAssets to have more discussions around ability to sell its medical necessity capability? And just maybe the tone of conversations with customers in that segment.

John Bardis - MedAssets, Inc - Chairman, President, CEO

Yes, I think -- and if I understand you right, George, I think the question you may be asking us to respond to is around the whole notion of inpatient versus observation patient.

George Hill - Citi - Analyst

Yes, that's where I'm going.

John Bardis - MedAssets, Inc - Chairman, President, CEO

(Multiple speakers) announce us in. And there was a very effective company that was sold a little less than a year ago that does this work very well. And the name of that company is EHR. And to my knowledge, the services that they provide remain in strong demand. In addition, one of the more public issues that has been raised recently were between two publicly traded hospital companies where there was some question raised about the level at which observation versus inpatient billing was being deployed.

We do have the capability of doing elements of this, particularly in our RAC audit area, but it is an area that in our view in the longer run has less value, particularly in an ACO pay-for-performance

environment. So in the near-term, we're talking about literally billions of dollars that change hands as a result of effective management of this issue. But in the future, the inpatient versus observation status we believe will have no effect whatsoever on the reimbursement, which will be driven more by performance related medical care as opposed to status.

Eric Coldwell - Baird - Analyst

I wanted to get back on this question that Ryan brought up early in the Q&A. Gross margin -- or I'm sorry, cost of revenue as stated tonight, and I don't know if you're going to reclass this as some point, but for the first quarter of '10 \$39.3 million, for the first quarter of '11 \$29 million. Could you help us go into a little more detail on what's changed here? Because that obviously was a very big variance year-over-year and an equivalent step up in G&A.

Have you taken a look holistically at your accounting model and decided to move certain costs into G&A? And is this just Broadlane? Could you just give us some more details on this?

Chuck Garner - MedAssets, Inc - EVP, CFO

Yes, so we can provide some further commentary. But for the most part it had to do with how Broadlane had classified more costs in their cost of revenue versus how MedAssets had categorized them. So when you're looking over at that year-over-year comparison that largely explains the difference.

So I think as you look at the cost structure and the way in which to categorize in the first quarter actuals for this year will be reflective of what you would see throughout the rest of the year. We basically conform the Broadlane's accounting and categorization to be consistent with how MedAssets had categorized these items historically.

Eric Coldwell - Baird - Analyst

And historically there wasn't a tremendous amount of seasonality and gross margins. So in the ballpark, something in this high 70s percent area should be our quarterly run rate then.

Chuck Garner - MedAssets, Inc - EVP, CFO

I think that's right. We would not expect to see the difference you're looking at on this first quarter '11 versus a year ago basis. You would not expect to see that play out as we go forward through the rest of the year. It should be much more smooth and consistent.

Eric Coldwell - Baird - Analyst

And just kind of more of a broader market question. I know that there's been an increasing trend among some of the cooperative GPO owners' members to take their purchasing capabilities with their GPO. And

then go out into the market talking to rural, small independent hospitals, et cetera and offering them affiliate programs to kind of piggyback on the sourcing without becoming traditional GPO owners per se.

I know there's been some pretty big growth in that area. What do you think of those dynamics? And have you seen any competitive share loss related to it? What would be your response on what some of your competitors are doing?

John Bardis - MedAssets, Inc - Chairman, President, CEO

Let me just address the last question first. We have not seen a change in market dynamics. I also would say that it validates the reality that large group purchasing can have some real advantages to smaller institutions. And so we've had a large rural and, if you will, non-hospital surgical center for example, assisted living center, and clinic business for a long period of time. I think we have over 90,000 non-hospital smaller providers who are central, for example, in particular in rural environments. But we also have a large number of smaller hospital clients who'd also take advantage of this.

Now I would also say that I think that in particular our capabilities in combination with Broadlane do make it harder for the traditional co-op model to compete, which has largely been focused on reasonable pricing, but not great pricing. What has been high pricing in physician preference item categories. But depending upon a share back as an incentive, as a shareholder to create value. And what we've said all along is that 100% of a 3% share back does not compare to a 20% or 25% price discount. You just can't compare the two. So it doesn't surprise me that alternate care markets are becoming appealing or even necessary for those businesses to sustain growth.

Caroline LeCates - Stifel Nicolaus - Analyst

I'm just wondering if you could provide a little more detail on the deferred payment interest expense accretion? And yes, deal related depreciation. I'm just looking at the cash EPS reconciliation.

Chuck Garner - MedAssets, Inc - EVP, CFO

So I believe you're referring to the deferred payment we have to the first part of January 2012, \$125 million. We're showing a balance, obviously a bit less than that as we end up accreting that up to the \$125 million balance effective January 1st up to the fair value. And that's largely the biggest difference you see there for the adjustment.

David Larson - Leerink Swann - Analyst

Looks like the revenue that you're talking about for the next couple of quarters you've given pretty detailed guidance. And I'm just wondering how much of that depends on growth in the revenue cycle services line item? And also if maybe you can talk about the revenue services division, like how many

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folks currently are not, I guess billing in the field that could be and sort of what plans might be for them in the future? Thanks.

Chuck Garner - MedAssets, Inc - EVP, CFO

Well, certainly a couple of opening comments. We'll let John add to that. So we don't have capacity sitting idle in the field, if that's the way the question -- waiting for revenue. Our growth outlook is certainly balanced across both our spend business as well as across our revenue cycle management segment, meaning both our revenue cycle technology and revenue cycle services.

I think as we said in the last quarter's call, we've taken a bit of a more cautious, more patient tone, given some things we know we need to improve on our revenue cycle services business. But that said we know that there is demand in the market, we're seeing there's interest both for services as well as interest for technology. And our outlook for the year contemplates balanced growth across all three of those pieces of our business.

John Bardis - MedAssets, Inc - Chairman, President, CEO

And also I would share with you that we needed to quite frankly clean up our act on revenue cycle services before we could aggressively sell a solution and do so for us in a profitable way. And so one of the first things that had to be done was not only for the business to be properly organized, but also to be properly costed.

And Greg has spent a great of time solving for that. And I feel that we're in a good position now to go forward. And that when we gain clients that we do so in a way that's predictable and profitable, and then enabling us to also manage the on boarding of employees in key areas of service that remains profitable.

Though the intermediate and longer-term strategy for us is in the magic of combining our revenue cycle services with our revenue cycle technology. Because when you look at Collections Manager for example, it dramatically improves the productivity of our capacity as a service provider to manage collections. And of course that's also true, equally true in institutions where we're not the obvious service -- where we're not the service provider.

So I think that the business is structured now to grow, but grow in a way that's predictable relative to profitability. And that's what Greg's focus has been for revenue cycle services.

Bret Jones - Oppenheimer - Analyst

When I look at the contracted revenue in the spend management side and I back out broadly, it looks like the MedAssets' core contracted revenue grew 22% year-over-year. And I was wondering if you could talk to how much of this growth is tied to incentive fees versus maybe new customer wins?

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John Bardis - MedAssets, Inc - Chairman, President, CEO

Well, first of all you're a very smart guy. You absolutely got it right.

Bret Jones - Oppenheimer - Analyst

Thank you.

John Bardis - MedAssets, Inc - Chairman, President, CEO

By a wide margin our model is working well, but it's also a reflection of the depth of our sales capacity. And so when we take the strength of the Broadlane portfolio with what historically was a pretty thin sales force. Pat was just getting to the point where he was investing in a sale to field sales organization. We think -- we like to believe we can longer term replicate what has been the MedAssets growth rate in this business. But it's a great pickup.

Bret Jones - Oppenheimer - Analyst

But can you talk about the mix of incentive fees at all or is that not something you want to touch on?

Chuck Garner - MedAssets, Inc - EVP, CFO

Certainly at a high level and we've made some, I believe, some brief remarks earlier regarding certain accounts. For example, Texas Purchasing Coalition where there are meaningful performance related fees due to us achieving certain results, along with our clients. And those are certainly in our forecast toward the back end of the year in terms of when we recognize those.

John Bardis - MedAssets, Inc - Chairman, President, CEO

Yes, Bret the other thing I would say to you is we welcome the opportunity to compete and put performance fees on the table in that we've -- in the spend management arena we have never missed one. We've hit every single one of those. And we think it's a differentiation. Because what we do do here is we data manage using technology to predict, project, and -- predict performance and change it. So it's not just a pricing issue in terms of how we manage contract pricing, but rather the overall cost management of an institution to deliver clinical results.

So we intend to bring those tools to a number of existing Broadlane clients. I will say that we've had some solid success early on in some of the existing Broadlane legacy client base.

Bret Jones - Oppenheimer - Analyst

Thank you. And then, John, one other follow-up question on spend management. It sounds like earlier in the Q&A you were talking about as you evaluate and look to consolidate the vendor contracts that you're also seeing a lot of the contracts with the best pricing also have the higher fees, at least in general terms.

How far along are you in this evaluation process? And do you expect that opportunity to be greater than \$50 million on a gross basis? And should we expect to see anything this year?

John Bardis - MedAssets, Inc - Chairman, President, CEO

Yes, great question. We're very far along on the analysis of it. So we understand where the opportunity is, Brett. What the reality of the process is, is it will take time. What I mean by that is we can't very well go to an existing contract and change its administrative fees, for example, for an exiting MedAssets vendor relationship. But where we're able to integrate a Broadlane agreement with an existing MedAssets client, who makes the choice to transition to that contract and commit the volume, it's a winner.

Let me be more specific why this makes sense on both sides of the ledger, in other words for both vendors as well as providers. If you look at the average, for example, Class III medical device company, their SG&A is in the mid-30s. If you look at a standard medical product company, their SG&A is in the mid to upper 20's. And so these are very large dollars.

In other words, because you can't advertise and the web is not an effective way to sell medical products to large industrial buyers, sales forces are very expensive, highly paid organizations that certainly the costs continue to become a greater and greater focal point for hospitals that vendors either through manufacturing or their marketing costs have to find ways to reduce their expenses. And one of the most compelling ways is to get committed volume and not have to have a sales force or even a service force there to implement those contracts or sell to individual clinicians within the institution.

So in a very collaborative way we're able to work with manufacturers to help them drive out their own costs while facing reductions in price and yet preserving or actually improving margins. And that's why manufacturers have been willing for committed volumes to produce or offer higher fees in exchange for the commitments.

Atif Rahim - JPMorgan - Analyst

I guess, Chuck, just looking at the numbers you provided for guidance for 2Q and 3Q, the implied 4Q numbers definitely seem to imply a higher ramp up in EBITDA margin than I'd expected. So other than the incentive fees that you have, is there anything else that would be driving those numbers? And if possible, could you just break out the magnitude of those fees that will be coming in? Kind of the guaranteed performance fees that'll be coming in in the back half that you have good visibility on?

Chuck Garner - MedAssets, Inc - EVP, CFO

Yes, well certainly the margin is higher in the back half of the year, largely due to two -- well, dollars are certainly higher from a revenue perspective as we talked about given a number of guarantee related items coming in. And then certainly the margin on those revenue dollars is higher. It's largely profit at that point

because we for the most part delivered and deployed the expenses to get there. And then it's being reimbursed for the achievement of those performance targets.

So that's where you'll -- as you probably looking at your model toward the end of the year and the outlook, you'll likely see both revenue dollars going up in the end of the year, as well as margins going up as well.

Atif Rahim - JPMorgan - Analyst

And the magnitude of those? Or is there anything else going on outside that?

Chuck Garner - MedAssets, Inc - EVP, CFO

No, I think that's for the most part the explanation. Certainly between now and then we have, as we said earlier, some performance fees to deliver between now and then. We have some new business we need to sign between now and then so we can recognize the revenue in this year. And those are largely again just operational executional areas of focus for us.

Chuck Garner - MedAssets, Inc - EVP, CFO

All right, everyone. Well, thank you again for participating in our conference call. We look forward to seeing and speaking with you soon and have a terrific evening.

END