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HMSY - Q3 2018 HMS Holdings Corp Earnings Call

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## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the HMS Q3 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded. It is now my pleasure to introduce Mr. Dennis Oakes. Please go ahead, sir.

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

Thank you, Andrew. Morning, and welcome to the HMS Earnings Conference Call for the third quarter of 2018. Joining me are Bill Lucia, our Chairman and Chief Executive Officer; and Jeff Sherman, our Chief Financial Officer.

This call is being webcast and can be accessed by the Investor Relations section of our company's website at hms.com.

Today's earnings release as well as an investor presentation containing supplemental information are posted on our IR website. Bill and Jeff will first provide their perspective on our quarterly financial results as well as an updated revenue outlook for the balance of 2018 and then we will open the line for questions. (Operator Instructions) Before we get started, I want to remind you that some of the statements we will make today are forward-looking, based on our current expectations and a view of our business as we see it today. Such statements, including those related to our full year 2018 financial outlook, future performance and future business plans and objectives, are subject to risks and uncertainties that may cause actual results to differ materially. As a result, they should be considered in conjunction with the cautionary statements in today's earnings release and risk factors described in the company's most recent SEC filings, including our Form 10-K. The financial results in today's earnings release reflect preliminary results, which are not final until our third quarter 2018 Form 10-Q is filed. Finally, we may refer to certain non-GAAP measures this morning, and a reconciliation of those measures to GAAP is included in both our earnings release and the investor presentation.

We're now ready to begin. Bill?

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

Thank you, Dennis, and good morning, everyone. When the year began, our stated focus was to improve execution in our core businesses. Coordination of Benefits and Payment Integrity, while also continuing to integrate the Eliza acquisition and innovate in our emerging total population management or TPM business.

Our strong financial results through the first 3 quarters reflect the significant progress we have made on each of these fronts. Year-to-date revenue growth of 8% in our COB business and 18% in Payment Integrity form the foundation of the 16.5% increase in total company revenue year-to-date, excluding the first quarter reserve release. Fulfillment of our strategy over the past 2 years to diversify our service offerings to include care management, consumer engagement and risk intelligence has also been significant contributor to that expansion in year-over-year revenue. In addition to this top line growth, our ongoing and disciplined cost management initiatives have led to meaningful improvement in earnings and adjusted EBITDA, which Jeff will discuss in greater detail. Our TPM Suite was assembled via both acquisition and internal development. Our move into this more consumer centric segment of healthcare delivery is the result of responding to issues that our customers told us they needed help addressing, in a manner that leveraged our core analytic capabilities, industry-leading data assets and client relationships. We expect TPM will be the fastest-growing portion of our business over the next several years, as we are only in the early stages of cross-selling into our expansive customer base. A good example of the value we deliver to our health plan clients and their members was evident as hurricanes approached the Carolinas in September and the Florida Panhandle last month. We reached out to over 1.3 million members for one of the largest customers, to let them know in advance of hurricane Florence, that they were preapproved for early refills of life-sustaining drugs. We developed a member contact script in consultation with the customer, recorded it and were making outbound calls within 24 hours. Such assistance to keep individuals healthy during a natural disaster has real impact to our customers and to their members, far beyond the timeframe of the immediate events.

Another important strategic decision made about 3 years ago, which has contributed significantly to our recent performance, was to ramp up our capital spending on technology, in order to create a sophisticated, Big Data environment, which leverages artificial intelligence, machine learning, natural language processing and robotic process automation. As a result, we can now more rapidly adjust and analyze huge data sets, develop new and more sophisticated analytics, organize records more effectively, streamline processes and reduce manual interventions.

We believe, we are only in the early innings of getting full value from our technology investments. To date, we've seen some of the greatest lift in Payment Integrity, but the positive impact is evident throughout each of our service areas.

In addition to productivity gains, we are increasingly using technology to fine-tune and better align our services with the needs of our customers and their members.

Beyond those internal factors, which have contributed to our year-to-date outperformance, the macro environment continues to present challenges for our customers, which in turn creates opportunities for HMS.

The upward trajectory of healthcare spending, an aging population with increasing incidence of chronic conditions, demands by employers to achieve more cost savings and an increasing emphasis on enhancing the consumer experience are among several external factors which are squarely within our expertise to address. In short, our services are needed now more than ever, as HMS solutions can help our customers bend the cost curve and more effectively engage their members at critical decision points, to improve health outcomes and increase member satisfaction.

Moreover, these same challenges present major headwinds for federal and state budgets as Medicare and Medicaid expenditures continue to escalate. We are therefore constantly educating CMS and our 40 plus state customers about the breadth of our full cost containment and care enablement solution set. The recent passage of legislation in Congress to address the devastating opioid epidemic presents opportunities for HMS as well. The measure, which was signed into law last week by the President, includes critical funding and many tools to help combat the crisis.

Certainly, the risk analytics in Elli are tailor-made for addressing the problem. More broadly, our extensive data warehouse, analytics, care management and consumer engagement tools can all help to identify and address opioid misuse.

HMS can also assist with identifying erratic or abusive prescribing patterns, and measuring the effectiveness of new opioid treatment initiatives. So we look forward to partnering with states, CMS and others, as they develop programs pursuant to this new federal funding.

We have a corporate mission to reduce payment errors, eliminate healthcare waste and to help consumers lead healthier lives. These objectives, together with a relentless attention to serving the needs of our customers, is what motivates our work.

We are very fortunate to have a highly skilled and dedicated workforce, who share a commitment to quality, operational excellence and continuous improvement. HMS was recently certified as meeting the requirements for the international organization for standardization, or ISO, Standard 9001, which is focused on a company's quality management systems.

It is a recognition few entities in the healthcare industry have achieved. So we are very pleased with the certification. Looking now more specifically at the quarter just concluded. I want to highlight 2 items: First, the record quarterly revenue, which supports our decision to again raise our full-year revenue outlook to a range of $595 million to $600 million. Second, our recent Eliza and Essette cross sales continue to be encouraging and the pipeline is growing, even after closing some of the deals I spoke about on the last quarterly call. We have signed several contracts in recent months, and have more in the final stages of negotiation, which should begin to contribute to revenue early in the new year.

All in, we are very pleased with our year-to-date execution against our 2018 objectives. But we do intend to work hard for year end, in order to finish strong and continue building a solid foundation for growth in 2009 -- '19.

Jeff will now provide some additional color on our third quarter results. Jeff?

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**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

Thank you, Bill, and good morning. We are very pleased with our third quarter performance, as nearly every key metric we track internally came in above plan. We had a very profitable quarter, with impressive revenue gains across-the-board, continuing growth in adjusted EBITDA, an operating margin approaching 16%, an adjusted EBITDA margin just under 27%, and operating cash flow in excess of $30 million.

We did have a tax benefit of $0.03 in the quarter, which was the result of a tax optimization project, which began in 2016. The total benefit was approximately $2.9 million, with roughly $500,000 of that total relating to 2018 and $2.4 million for prior tax years. We recognized the benefit in the third quarter, due to the completion of audits relating to prior year state tax refund claims, which resulted in a revision to our apportionment methodology and approval of certain tax refunds. Third quarter commercial revenue was a quarterly record, up nearly 8% sequentially, and commercial revenue is up over 24% year-to-date. That year-over-year comparison is inflated a bit by the fact that we did not acquire Eliza until April of last year, but even excluding Eliza from both years, commercial revenue is up over 15% through the first 3 quarters. Working through the inventory of implementations we had when the year began, has also been another source of revenue enhancement throughout 2018.

We have significantly increased monthly throughput, accelerating revenue generation for our customers and HMS. Through October, actual implementations have exceeded our expectations in every month this year. In addition to increasing the number of implementations, we can now process monthly compared to last year, we have continued to enhance our reporting and tracking metrics. We indicated when the year began that we wanted to reduce the active implementations inventory to roughly 2 quarters of sales, and we are on track to do so by year-end.

We are raising our revenue guidance today by $20 million at the bottom end and tightening the range to $5 million as we go into the final quarter of 2018. As we mentioned on our second quarter call, our full-year revenue guidance does include the $8.4 million Medicare RAC reserve release in the first quarter, and our full year adjusted EBITDA guidance includes the net impact of $6.3 million from that reserve release and an add-back for the $20 million nonrecurring settlement in the second quarter.

Third quarter revenue was unusually strong, so we suspect there may have been a bit of pull forward revenue, which is why our revised guidance implies fourth quarter sequential revenue that is roughly flat to up slightly. The third quarter, once again, demonstrated the leverage in our operating model, as incremental revenue continues to largely fall to the bottom line, boosting net income, adjusted EBITDA and margins, as we continue to diligently manage cost. Assuming we hit our target for fourth quarter revenue, we currently expect to exceed the top end of the revised full-year guidance range we provided with our second quarter's earnings release on each of those measures. We have been quite disciplined in our cost management activities, which has contributed to margin expansion and bottom line improvements. Stock-based compensation in the quarter of $3.4 million was consistent with our expectations, and we continue to expect full-year stock comp of approximately $21 million.

CapEx in the third quarter was $6.8 million and totaled approximately $19.4 million through the first 3 quarters. That is somewhat below the run rate we anticipated in order to reach the full year projected total of $33 million, but we do expect capital spending to pick up in the fourth quarter. The nonrecurring cash payment of $20 million for the settlement in the prior quarter reduced operating cash flow to $9 million, but it rebounded to $31.8 million in the third quarter.

Our cash balance at September 30th was nearly $125 million. As we continue to rebuild on liquidity following the Eliza acquisition last year, we are monitoring an active pipeline of potential acquisitions. We intend to remain disciplined in our approach, so the mere fact that we are accumulating cash will not dictate our dealmaking pace. We do view acquisitions as a component of a long-term growth profile, so we will continue to diligently pursue opportunities of interest. Our current emphasis is on technologies that would enhance either our Payment Integrity or total population management services. The process of finalizing our 2019 budget will continue through the end of the year, so we will be providing guidance for next year on our fourth quarter call in February, as has been our custom for the last several years. As we close out the current year, we're very encouraged by the progress we have made throughout 2018, which we believe should position us well to achieve our full year objectives. Bill will now provide some closing thoughts and then we'll be ready for questions. Bill?

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

Thanks, Jeff. As health care in our nation is to move forward on a better path, we believe, companies like ours have an obligation to be thought leaders.

At HMS, our internal innovation efforts are designed to find new and better ways to reduce waste, more effectively engage consumers and facilitate better care interventions to improve clinical outcomes and lower costs. To advance those efforts, we recently hosted our annual momentum conference, where we brought together customers and a host of highly regarded healthcare executives, startup entrepreneurs, authors and industry experts to explore the future of healthcare. Helping healthcare entities fight rising costs and providing tools to allow their members to better manage their health are at the heart of our business. We take pride in the contribution we make to improving the healthcare system but realize there is much more to do. We will continue down our path to develop innovative, value-added services for our customers to meet their current and emerging challenges.

In closing, I want to thank all of my colleagues at HMS for their hard work through the first 10 months of 2018, and remind everyone how important it is to keep pushing through year-end.

Achieving our full-year financial objectives is in sight, but it's critical that we each stay focused on our respective roles in order to get across the finish line. I also want to let our shareholders know how much we appreciate their support and confidence in HMS.

Andrew, we're now ready for the first question.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from the line of Mohan Naidu with Oppenheimer.

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

As we start the selling season, can you update us on the traction with Elli so far in this season?

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

Sure, Mohan, this is Bill. We've got a number of clients in the contract negotiation process. Because the Elli's sold on a PMPM basis, so it's not a -- while we think there's great return on investment in the product, it's not sold on a self paying contingency fee. We're typically probably coinciding the sale of the product with health plans' budget cycles. So we expect to, by the end of the year, have additional clients contacted and -- in the implementation process for the product. We are using the risk intelligence of Elli to better inform our Eliza and care management solutions. We hope that will drive incremental revenue in 2019, as well as the integration of all 3 products in the marketplace.

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

Okay. And on the TPM side, it looks like you guys are getting a lot of traction there. Given the momentum there, are there any new solutions that you can add to expand on the current portfolio and leverage the momentum?

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

Well, yes, so that's really, I mean, as we -- as Jeff mentioned in our prepared remarks, the 2 areas where we are actively looking at, services are in both Payment Integrity and total population management. There are a number of organizations, both service operations and technology platforms, that we're looking at to expand our footprint in population health. And there continue to be what I would consider technology solutions that are more consumer oriented, but sponsored by health plans or employers or potentially government that we're looking at.

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**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

Yes, and I would just add. I mean, we are focused on companies that can provide actionable analytics to our customers in a very short period of time. So there is a fair amount of activity still going on in the marketplace, we've looked at a lot of opportunities and continue to do. Again, we want to make sure it fits the right long-term strategic profile of the company, can supplement our growth profile and be additive to our services that we're offering to our customer base. So I would expect over time, we'll see more acquisitions, I think we've taken a very disciplined approach and expect to continue to with regards to return profile and ability to complement our existing service mix.

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**Operator**

And our next question comes from the line of Ryan Daniels with William Blair.

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

Couple of quick questions for you. First off, if we think about all the inventory you have, that's now moving through the ink to green process quicker, but you still have some remaining, plus the recurring nature of your model, plus the pipeline. How much visibility you think you have into kind of the 2019 revenue outlook at this point in the year?

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**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

Yes, Ryan, this is Jeff. I think to your point, given the large installed customer base we have and the very much recurring nature of most of our revenue, as we exit 2018, we have very good visibility into 85% plus of our revenue for 2019, and that remaining 15%, a lot of it is, for instance with Eliza, we may not have contracted revenue in place, per se, but the revenue is recurring in nature, meaning we do the same work for customers every year. So I would say, we will expect to leave 2018 with very good visibility on the vast majority of our revenue we're expecting for 2019. And I think the good news is, as we get better at implementations, we can increase the throughput speed from a sale to actual revenue generation. And I think importantly, as we went through 2017 and 2018, getting that better visibility on implementations and being able to prioritize implementations, basically real time now, for impacts to both our customers and HMS, that's going to be important to drive revenue in current year with sales that are occurring both in the fourth quarter of 2018 flowing into 2019 and sales that are occurring in 2019.

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

Okay, that's very helpful. And then my follow-up question would just be on some of the IT investments you have made and will be making. I know you've talked about AI and machine learning to drive yield and process more claims a fixed labor force, that's probably helping with implementations. But can we get an update on the status there? And maybe the outlook for the coming 12 months, and kind of the key priorities on the IT investment and CapEx spending?

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**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

So CapEx has stepped up meaningfully. We expect to be over $30 million for 2018, and while not providing guidance yet for 2019, I think we would expect still an elevated level of CapEx. And really, we have CapEx falling into a couple of buckets, we just have routine where we characterize as "keep the lights on" capital investment. And then we have investment for product expansion and product development. And then finally, some of these other investments we've made that have helped accelerate revenue generation and taking out cost. So I would expect 2019 those investments to continue. As Bill pointed out in his prepared remarks, as we look at the impact we're getting from these investments, we really think we're in the early innings of capitalizing on the benefit from these investments. And so I think continuing to make these investments is going to be a priority. I think we're going to be focused on for 2019, how do we rationalize the investments that have the most impact to our current and future performance. And I think as far as the benefit, as we continue to see the benefit, we'll continue making these investments, which really have a long-term payback profile that I think will be quite helpful to margin expansion over time.

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**Operator**

And our next question comes from the line of Ana Gupte from Leerink partners.

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**Anagha A. Gupte** - *Leerink Partners LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

I had a question around the payer mix. You have a nice lift on your commercial payer mix here, your gross margins are looking good. Can you give us a sense of what the components are of that? Is that mainly managed Medicaid? What type of uptick are you taking getting in the Medicare Advantage arena? And then just on employer commercial at all, if there's any lift there?

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**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

Ana, so still the vast majority of our health plan revenue is managed Medicaid. With the acquisition of Eliza, we have seen the true commercial mix actually go up. And so commercial and Medicare Advantage make up a little bit more than 20% of the health plan revenue, with managed Medicaid making up the balance. I think what that points out is, even with the strong growth we've seen, we still have a significant upside potential both in commercial and in Medicare Advantage. And as we see, our employer work, we characterize as true commercial, as we see continued interest from employers in our products and services as well, we see a great opportunity to expand into the employer market, which will drive that true commercial mix as well.

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**Anagha A. Gupte** - *Leerink Partners LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

Okay. And then on the Payment Integrity with the growth there. How much of the growth is being driven here by your technology and AI and getting more throughput versus savings rates going up? And it looks like you may be entering the prepaid side. Can you talk a bit more about what the drivers of the growth are there? And what you're seeing in the competitive environment, in postpaid particularly, be it the margins there and then in prepaid, any updates?

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**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

First, with the relatively large installed customer rebate -- base we have in our core COB business, that gives us the platform to sell into Payment Integrity. And so most of the revenue growth is coming from existing customers and seeing our performance improve. We did talk about, really in the third quarter of '17 and in the fourth quarter, we were using technology to significantly lift the number of medical records we were requesting, that ultimately drives PI revenue. The technology investments that we made, including natural language processing, artificial intelligence have helped us to accommodate that growth with minimal incremental cost and so we're seeing an improvement in finding rates, we're seeing an improvement in no finds, so we're using technology to say, which of this claims we don't need to be looking at, and therefore, getting more effective in terms of our performance. So I think those investments will continue, and from a payment integrity perspective, as we exit the third quarter, the growth continues. And we've had one of our strongest non-RAC PI quarters in the third quarter of this year and feel good about our growth profile for next year.

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**Operator**

And our next question comes from the line of Jamie Stockton with Wells Fargo.

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**James John Stockton** - *Wells Fargo Securities, LLC, Research Division - Director & Senior Equity Research Analyst*

I guess, maybe the first one, the comment about potentially pulling some revenue forward from Q4. Should we think about that as primarily being a COB aspect?

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**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

It's a little hard to flesh out. If you remember last year, we have a -- we had a significant amount of revenue that was pushed from Q3 into Q4, which is primarily COB driven. But I think if you look at the midpoint of our guidance, that full-year guidance we gave, you'd see -- we see Q4 revenue be fairly consistent, may be up slightly to Q3. And I would expect the overall mix in the fourth quarter will remain somewhere as it has been on a year-to-date basis.

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**James John Stockton** - *Wells Fargo Securities, LLC, Research Division - Director & Senior Equity Research Analyst*

Okay, that's a great. And then, Bill's comment about just seeing kind of the first benefits of the investments that you guys have been making in Big Data. With respect to program integrity specifically, do you feel like the benefit that you've gotten there is more materializing in a lower cost structure for that business because you've been able to automate a lot of stuff that you historically had to throw labor at? Or is there more of our revenue benefit that you have seen, because you've been able to maybe address some opportunities that you hadn't been able to address before?

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

It's actually both. We started really with the ability to generate more from our findings against the data, which of course, is something that we constantly innovate and invest in to determine how we can find either more problems in their clients' data or address problems that the customers are having that we can address through our Payment Integrity product. And then automate more of that, both the analytics that drive those findings, but also the processes that support and/or automate a internal nurse or coder's review. So it's really a combination of both. And I think going forward, we will continue to focus on both the driving higher revenue and volumes through a lower cost structure.

**Operator**

And our next question comes from the line of Sean Dodge with Jefferies.

**Sean Wilfred Dodge** - *Jefferies LLC, Research Division - Equity Analyst*

May be putting some numbers around -- we were just talking about. On the commercial revenue, if we look at the sequential progression there, can you parse out for us how much that was driven by new clients versus improvements you made in productivity? You guys, Jeff, you mentioned the progress you've made streamlining implementations, the productivity, what we were just talking about with Jamie, using things like machine learning to elevate the number of records. I guess, how much came from the implementations versus more on a same-store basis driven by the technology investments you've made?

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

So, this is Bill, I'll start and then Jeff can follow up. Just a reminder in general, 80% of our sales comes from the same-store, so -- what that means is, is that at any given time, our implementation queue is representative of that, about 80% of the projects in implementation are enhancements, additions, expansions with existing clients, which we still think we have significant whitespace opportunity. But that's typically where we see a large amount of our sales. And then the balance, the 20%, is new logos. You'd expect to see more new logos in Payment Integrity and total population management than you would in COB at this point, though there are still new logos to be found in that product line. Jeff?

**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

Yes, I would add. I think it's important to note, we have dedicated yield teams in the company, whose sole purpose is how to drive more revenue out of the existing customer base, both by using technology investments and process improvements and how we ingest and manage data more effectively. That's a key focus of ours, it drives incremental revenue, it drives highly accretive incremental revenue, because that cost infrastructure is in place, so the ability to improve yield both for COB and Payment Integrity is a component of revenue growth for us. It always has been, and expect it will continue to in the future, and it's an area where making those investments has a really tangible value to our bottom line performance.

**Sean Wilfred Dodge** - *Jefferies LLC, Research Division - Equity Analyst*

Okay, that's helpful. And then, I guess, Medicare RAC revenue is up a bit sequentially, is there anything changed or worth noting about the outlook there?

**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

I think we continue to gain traction in terms of the types of edits and audit scenarios we're submitting to CMS for approval. We have been submitting, we believe, the highest number of auto-requests or approval requests, so I think we're just getting traction from CMS and improving those and seeing good results. We are still hopeful that we'll be able to see the ADR limit or the amount of audits that we can perform be increased from the very low level of 0.5% -- I'd remind everyone in January of '17, it was reduced to -- from 2% to 0.5%. So the ability to see that increase could have an impact on our revenue. So I think we're having good progress there, we're hopeful that we can see some expansion in the number of audits, but we are seeing the pace of audit scenarios being approved by CMS pick up, which we think is a good thing heading into 2019.

**Operator**

And our next question comes from the line of Matthew Gillmor with Robert Baird.

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

I was hoping to get an update on the sales strategy and the go-to-market strategy, and I guess, with the broader offering, you're touching a lot of different elements with your clients, and so do the -- do the conversation evolve to be little bit more strategic and will that create a little bit more lumpiness with your sales in the future?

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

This is Bill. I don't know if it will create more lumpiness, particularly because, most of the -- so as we said, TPM's our fastest growing segment. A lot of the sales there are transactional or per member per month. So when you think about Essette licensing fee, so we've had a very strong season right now in terms of Essette sales, the product continues to advance, we're really, for the most part, licensing that at a per member per month fee or a fixed fee that's spread over time. The -- as well are the implementation fees. And then you have Eliza, which is transactional or per member per month. So I don't think we're going to see from our new sales activity significant lumpiness. We could have, and always have had in the past, times where we've had slight blips in the quarter when we first implement a client, either in Payment Integrity or COB. And as we implement new COB accounts, which we still do on occasion, we'll see backlogs of -- because of Medicaid's right to recover for 3 years. So I don't think you're going to see a lumpiness based on our go-to-market strategies or our sales.

**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

And our focus really is on building the sales pipeline for all of our major customers, so both at the commercial level and the government level and by our service offerings as well. As we have gotten better at, I would say, a couple of things, estimating what the real value of a sale is and getting -- and gotten better on our implementation process, I think we have better visibility from a forecasting perspective of how that revenue is going to flow on a monthly and quarterly basis. So that visibility is helpful for us, for managing the business. It's also helpful to us to prioritize and have a different level of conversation with our customer, in terms of how big of an impact our services could have and what we need from them to get it into our queue quicker. And so having that visibility and confidence to know that we can have an impact in a certain period of time, if we get the cooperation for the customer, I think is good information that allows a higher-level, more strategic discussion, as we look to elevate our sales approach into the C-suites of our customers.

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

Got it As a follow-up, I wanted to also ask about the renewal cycle for the state TPL business. That does 2019 sort of shape up to be a normal year from a rebid perspective, and is there anything noteworthy from a competitive standpoint in that segment of the market?

**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

As the year began in 2018, it was a fairly typical year and included North Carolina, which was pushed from last year into 2018 in Georgia. There was 3 of our top 10 TPL states were coming due in 2018 and the results so far have been pretty encouraging. We did sign a new 5-year contract with California, which is set to start on December 1st. Georgia has extended our current contract for up to 2 years, with an additional 12-month extension in June -- through June of '19. And we expect North Carolina will probably extend their current contract. As we think about '19, we'll see if any additional contracts are signed by year-end. At the moment it appears to be a relatively light year with roughly about 10% of our state revenue up for reprocurement in 2019.

**Operator**

And our next question comes from the line of Richard Close with Canaccord Genuity.

**Richard Collamer Close** - *Canaccord Genuity Limited, Research Division - MD & Senior Analyst*

Jeff, I was just wondering if you could clarify, you had mentioned, with respect to implementations, something along the lines of 2 quarters of sales, and can we -- just was curious, if we could dig into that a little bit, what exactly that calculation is? And maybe where it was before the benefit from these investments? I guess, you're at 2 quarters now, where did it come from, just to give some perspective?

**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

Yes, we had -- we probably had 4 quarters-plus as we started the year. But I think as we get better at implementations, that's less of a concern for us. We wanted to have kind of a real -- a basically a -- we think 2 quarters is just kind of a normal backlog, based upon the puts and takes it takes to put a contract into actual revenue production. So I think as we've gotten better and more efficient and actually potentially having capacity, that's a good place to be from an implementation standpoint. So as we look at our 20 -- as we talk about our guidance in February for 2019, we'll have very good visibility for what's in the queue, when we expect it to hit by customer, by service type on a monthly basis.

**Richard Collamer Close** - *Canaccord Genuity Limited, Research Division - MD & Senior Analyst*

Okay. And then Bill, question for you, I guess. On the federal and state, can you comment, one, how real are the opioid opportunities? And then second, I was just curious to just get your comments on the upcoming election and assuming, we get some shifts to Democrats on the state level, maybe governor and legislatures at all. Are there any certain states that you guys are looking at in -- maybe the opportunity for a Medicaid expansion?

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

Yes. So the opportunities to help address the opioid issue with analytics are real. We're in discussions with everybody from health plans to state government to the federal government about what we're able to see through our data. Remember, the Medicaid data that we have represents about 90% of the nation -- the nation's Medicaid program, and it's historical and longitudinal, so we're able to look at things in a way that other companies just can't because they don't have access to that. So that's where our real, I'd say, strength is that we bring to the table. The Elli product comes off the shelf, so to speak, with an opioid analytics lens, and then of course, we're developing further tools around it, but anything from the -- like out of the box, the system comes with pregnant moms who are on opioids. That some things -- that sometimes our plans don't know and there's a lot of reasons why that might be the case, to us being able to identify erratic prescribing patterns, so that they can focus more in on the pill shops that are overprescribing. So those are real opportunities, there's federal funding for that now. And then the part, your second question about the gubernatorial races, I would guess the ones that are still somewhat hotly contested at this point and close are Florida and Georgia. I would -- I believe that in both states, if the Democrat is elected, they will push to expand Medicaid. That would be a positive for HMS because we have contracts with both the state for the fee-for-service population and with the major managed care plans for the Medicaid managed care population. But those are the -- I think those are 2 states with the closest -- that are closest in the current governor's race.

**Richard Collamer Close** - *Canaccord Genuity Limited, Research Division - MD & Senior Analyst*

And if they do expand Medicaid, how quickly does that flow to you guys? I mean how quickly can Medicaid expansion be implemented? Is that a 2019 opportunity or 2020?

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

I think depends on the state. So I don't remember exactly when Virginia approved their Medicaid expansion, but enrollments started the first of -- or it's starting the first of 2019. So there could be a lag time, but I think it's really dependent upon the state and how quickly they can get their systems up and running, with the new eligibility requirements and other factors. So it could be within the -- our fiscal year or it could be pushed out to the following fiscal year.

**Operator**

And our next question comes from the line of Stephanie Demko with Citi.

**Stephanie July Demko** - *Citigroup Inc, Research Division - VP & Senior Analyst*

As we head towards the end of the year, could you just give us an update on any catch-up spend activity that you're seeing within your commercial customer base? And to what extent this could help the TPM pipeline?

**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

Generally, Q4, for us, is a strong quarter. As our health plan customers look to finish for the year strong. I wouldn't characterize it, necessarily, as catch-up. We have said in the past, for instance, for our Eliza product suite, closing gaps in care tend to happen more in the third and fourth quarter, and so Eliza had a revenue pattern that was fairly similar to HMS, where the second half was stronger than the first half, in Q4, it was the strongest quarter. So I think we would expect that a similar outcome to occur in the fourth quarter of this year.

**Stephanie July Demko** - *Citigroup Inc, Research Division - VP & Senior Analyst*

Understood. One follow-up, could you give us an update on the Louisiana Elli pilot?

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

Well, it is for the state, it's a system that they've actually contracted with us for us. So it's no longer really in pilot with the state. That is where we have contracts that are in the process of negotiation or being redlined or in front of health plans in that state. So those are the -- that's where our first -- we believe, our first, what we consider, commercial Elli sales will come from. And again, as I mentioned, just like us, the health plans are going through their budget year and this is where they get their capital approval. So we would expect sales to close after they go to their budget approval process.

**Stephanie July Demko** - *Citigroup Inc, Research Division - VP & Senior Analyst*

And how long would it take from that ramp until that could be used as a proof point for other Elli sales?

**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

Probably be a couple of quarters, I mean several quarters at least, of results to use as a foundational platform.

There's a use -- there's use cases that are relatively quick that, when the client sees their data in the platform, they see -- they get alerts on identifications of things they didn't really know about. So that's been -- the clients who were in the pilot, the health plans who were in the pilot told us that. Now the return on investment, which is really how quickly did they engage a member, how quickly did they get somebody who is frequently using the ER, to start to seeing a PCP, all the other things that could come out of that, that would be the ROI that they'd see from this would take a couple of quarters probably for them to be able to measure. And of course, we'll be measuring right along with them.

**Operator**

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

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

Maybe just two things. First is, I know you're not going to quantify the revenue expectations for Elli in '19, but just curious if you think there'll be meaningful revenue generated from that. And I guess sticking in the pop health category, just on Essette, I'll be curious in terms of the competitive dynamic in specifically in the sales that you're having and success, I assume it's mostly greenfield opportunities versus replacement of existing products or solutions, but any color there would be helpful.

**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

So I'll start. So in terms of Elli, as Bill noted, given that it's going to be a subscription model of PMPM, and we would expect sales to be occurring over the next months and quarters, I wouldn't expect there's going to be a huge revenue impact from a materiality standpoint in 2019, I think we also are looking at selling it into the state market, which we know is a longer sales process and RFP driven. I do think we're seeing good receptivity, so I think it's going to be a long-term grower for us. And then, as we look to sell Elli in conjunction with Eliza and our Essette Care Management, as a complete TPM product suite, we think that's an opportunity that would take time to sell as well. And so were selling individually and are looking to sell in total, as a total package as well over time.

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

And then the Essette sales are almost always replacement, they've chosen us to replace an existing care management platform.

**Jeffrey S. Sherman** - *HMS Holdings Corp. - Executive VP, CFO & Treasurer*

And again, the sales process for that, that's not a -- that's like Eliza, where we can sell and implement sometimes in the same 30 or 60 day period, since you're already displacing another vendor typically and it's fairly intricate to the whole care management process, it is a long sales cycle.

**Operator**

Thank you. And that concludes today's question-and-answer session.

So with that, I'd like to turn the call back over to Mr. Bill Lucia for closing remarks.

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

Well, we want to thank everybody for your continued interest in HMS, and look forward to speaking to you again in February, when we will prereview our full-year outlook for 2019. Thank you.

**Operator**

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a wonderful day.

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