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HMSY - Q3 2017 HMS Holdings Corp Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the HMS Q3 2017 earnings conference call. (Operator Instructions). As a reminder, this conference call may be recorded.

I would now like to introduce your host for today's conference, Mr. Dennis Oakes for HMS Investor Relations. Please go ahead.

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

Good morning, and welcome to the HMS third-quarter 2017 earnings conference call. 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 through the Investor Relations section of our Company website at HMS.com. Today's earnings release, as well as an investor slide presentation containing supplemental information, are also available on our IR website.

In a few moments, Bill and Jeff will provide their perspective on our third-quarter financial results, as well as an update on our full-year outlook for 2017. Following their remarks, we will open the line for questions. We ask that you kindly limit inquiries to one question and one follow-up so we can get through the full list in a timely manner.

Before we get started, I would like to remind you that some of the statements we are making today are forward-looking statements and are based on our current expectations and our view of business as we see it today. Such statements, including those regarding our revised full-year financial outlook and future performance, are subject to risks and uncertainties that may cause actual results to differ materially and 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 2016 Form 10-K.

The financial results in today's earnings release reflect preliminary results which are not final until our third-quarter Form 10-Q is filed.

Finally, we may refer to certain non-GAAP measures this morning. A reconciliation of those measures to GAAP is included in both our earnings release and our investor presentation. We're now ready to begin.

Bill?

Bill Lucia - *HMS Holdings Corp. - Chairman, President and CEO*

Thank you, Dennis, and good morning, everyone. We have taken a number of steps throughout 2017 designed to achieve the annual growth we projected when the year began. Those include investments in our big data platform and the use of technology to streamline operations; internal yield enhancement activities focused on payment integrity and COB; our ink to green initiative, with an emphasis on both increasing the number of implementations and reducing the time for completing each project; and our ongoing sales activity, which is focused on expanding existing relationships and signing new logos.

Despite those efforts, our third-quarter financial performance was below expectations due principally to three factors. We did not get the lift we expected from payment integrity implementations and yield enhancement; run rate Eliza revenue was flat sequentially; and we experienced an unexpected drop in COB revenue from the second quarter, though our year-to-date COB revenue is up quite nicely.

We expected the investments we have made this year in people, technology, process improvements, innovation, and new product offerings would spur revenue growth both immediately and over time, but simply did not see the anticipated short-term payback in the third quarter.

Importantly, our customers are pleased with the results we deliver every day as evidenced by robust sales of our heritage COB and PI solutions. Those sales included two new commercial customers with about 700 lives added in the third quarter. We also recently won a new seven-year contract with the Commonwealth of Massachusetts. And the State of Connecticut extended our existing contract for three years. Both states included an expanded scope of service, so our state government business continues to be a source of future growth.

Additionally, the April acquisition of Eliza significantly expanded the solutions that we can now offer. I have personally been on a number of Eliza sales calls with existing HMS customers, and we are receiving a very positive reaction. In fact, we have already closed two cross sales, which should generate revenue before year-end and contribute to what we expect will be a solid fourth-quarter finish or Eliza.

I also want to point out that Eliza implementations typically happen much more rapidly than PI or COB. The usual cycle from sale to revenue is only 30 to 60 days, and we utilize a separate implementations team. As Eliza revenue grows, this revenue diversification will be a significant plus.

Year-to-date sales have created an implementation backlog which bodes well for future revenue growth, but also highlights the ongoing need to improve the operations associated with converting sold business to expected revenue. We do understand what needs to be done to boost revenue growth next quarter, and have plans in place to do so. The revenue shortfall this quarter will prevent us from meeting some key full-year 2017 objectives. We are confident, however, that the strategy and tactics we have been pursuing in recent quarters to both grow our payment integrity and coordination of benefits and to capitalize on an expanded addressable market with the move and to help management and member engagement, positions us well for the growth we are expecting. We are working diligently to improve financial results by year-end.

Jeff will now provide a more detailed review of our third-quarter performance and revised full-year outlook for revenue and margin. Jeff?

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Thank you, Bill, and good morning. I want to provide as much color as possible on the reasons our projections did not play out as expected in the third quarter; our current view of the fourth quarter; and what we are doing to achieve year-end and future revenue growth.

Let me begin by reviewing the factors which impacted our third-quarter performance. Though we have made steady progress over the past several quarters in our effort to increase our capacity to implement sold business and accelerate revenue generation, much more remains to be done. We have not gotten ahead of the curve because sales in recent quarters have outpaced our improved implementation capacity.

We have been intensely focused throughout this year on further improving the ink to green process and removing any roadblocks to executing against our internal plan, particularly with respect to payment integrity revenue.

One area of current focus is the multiple IT platforms and applications we have in place, which complicate already complex integrations with customers, and can present challenges as we seek to implement new sales. Our 2018 budget will include incremental investments in our IT infrastructure in order to enhance our speed to market and lower per-unit costs, which should drive revenue and margin growth. Going into the fourth quarter, we have realigned resources to focus on the implementations we expect will have the greatest short-term revenue impact for both our customers and HMS.

Looking ahead to next year, we plan to add resources in order to significantly increase our implementation throughput. Payment integrity revenue, despite our best efforts, declined from the third quarter of last year in the prior quarter. Compared to the prior-year quarter, the declines were across several accounts and for a variety of reasons. For example, we conducted short stay audits for two large national account customers in the year-ago quarter which generated more than $1.5 million, and neither did similar audits this quarter.

As we mentioned on our last earnings call, the first dollars of PI revenue are not typically produced for 90 to 120 days, even after successful implementation and the go-live launch. That process can be further elongated based on customer internal considerations, including concerns about the impact on their provider networks.

Audits delayed at the request of customers, for example, negatively impacted planned third-quarter revenue, though we expect some will resume in the fourth quarter. We are in the early stages of applying technology and machine learning to the entire payment integrity process in order to increase our capacity to identify potential errors with enhanced accuracy; stratify those with the most potential for the highest recovery dollars; and significantly step up the number of medical record reviews that nurses and coders can complete.

We have achieved a number of internal measures of progress in recent months, including significantly increasing the number of records reviewed per day, and recording a large jump in the number of medical records requested for review in September. Though such increases are only early indicators of potential revenue enhancement in PI, we expect their impact will be evident beginning in the fourth quarter.

Eliza revenue was flat with the prior-quarter run rate, which was several million dollars below our internal projection, and inconsistent with the historical pattern of higher second-half revenue, as customers focused on identifying and closing gaps in care. We are working through the typical integration challenges of any acquisition. And we accomplished a great deal in the quarter in terms of internal reorganization of the Eliza sales operation. But doing so impacted our ability to generate the incremental revenue we expected.

In addition to combining the Eliza salesforce with the HMS sales team, we stood up an account management function for the first time. This bifurcation of sales and account management is similar to what we have historically had in place at HMS for our commercial business, and is an example of investments we are making to ensure excellence in customer service in order to drive sustained growth over the long-term.

Just six months post- the Eliza acquisition, we see customer interest building which we anticipate will lead to cross sales of the Eliza member engagement solution into the HMS customer base, particularly with the midsized and larger regional Medicaid managed care plans and Medicare Advantage plans, where our work to improve HEDIS scores and Star ratings has tangible top-line impact for customers. We prioritized more than 60 existing HMS customers for the first wave of these cross sales, and initial client meetings began in the third quarter.

COB revenue in the quarter of approximately $90 million was up over 4% compared to the year-ago quarter. And year-to-date COB revenue is up 7%. It was down over $8 million sequentially, however; though the second quarter was our highest COB quarter ever, so a difficult comp. It is certainly not unusual for some revenue to be pushed into future quarters, but we ordinarily have roughly offsetting unplanned revenue, which was not the case this quarter.

COB is our core offering, consistently generating in excess of 70% of annual revenue. So it is important to note that we anticipate most of the COB revenue we planned for this quarter will be realized in future quarters, and we expect continued growth in our COB business via new sales and yield enhancements. None of the issues which arose in the third quarter appear to be systemic or permanent changes.

Operating cash flow was strong at $34 million compared to about $9 million in the prior quarter. And adjusted EBITDA was $34 million compared to $26 million in the year-ago quarter. Cash at quarter-end was close to $80 million as we continue to rebuild liquidity following the April purchase of Eliza.

As we announced this morning, our Board has authorized a new $50 million share buyback program. We view share repurchases as an important component of prudent capital allocation, and consistent with our overall commitment to building shareholder value. Our strong cash flow gives us the ability to both invest in the business, including future acquisitions, and return cash to shareholders via share repurchases.

Based on the third-quarter results and current expectations, we are updating our revenue and margin outlook for the fourth quarter and full-year 2017 as follows. We expect fourth-quarter revenue of approximately $135 million to $140 million, which translates to full-year total revenue of approximately $508 million to $513 million. And we do not expect to achieve the full-year margin expansion we projected, even excluding the impact of Eliza, as it was largely dependent upon the revenue growth we anticipated. The inherent leveragability in our model, however, should support operating margin improvement next year and beyond.

We have a number of action plans in place to achieve the projected sequential quarterly revenue growth in the fourth quarter. They include priority COB and PI implementations and several special projects with customers, as well as various yield improvement initiatives. Year-end state projects and a push by our health plan customers to meet full-year revenue targets typically make the final quarter of the year our biggest revenue quarter. It is an ongoing challenge to forecast revenue with quarterly precision, as our third-quarter results demonstrated, but we believe we are well positioned to achieve our revised fourth-quarter objectives.

Bill will now have brief closing remarks, and then we'll be ready for your questions. Bill?

Bill Lucia - *HMS Holdings Corp. - Chairman, President and CEO*

Thank you, Jeff. I certainly recognize the results this quarter are disappointing for our investors, my colleagues at HMS, and all of those who have a stake in our success. But I do want to assure everyone, however, that the executive team and our Board of Directors are enthusiastic about the Company's growth prospects, and fully committed to producing the financial results we know the Company is capable of.

We offer very attractive and truly differentiated solutions for risk-bearing entities that are seeking to contain costs and improve clinical outcomes by effectively engaging with their members.

To illustrate that point, I want to briefly mention how Eliza mobilized resources to help health plan members impacted by the recent hurricanes. One client identified several hundred thousand individuals who they anticipated might run out of life-sustaining drugs, including insulin and seizure medications, during the impending storms. Within 24 hours, Eliza put in place an electronic communication plan to let those members know they were preapproved for early refills so they could pick up their medications before the storms hit or they had to evacuate.

We assisted another client with outreach to about 250,000 of their members, providing health-related tips on hurricane preparedness. We received extremely positive feedback from our customers for those activities, because their members reacted very favorably to the unexpected outreach.

Insightful industry observers like Gartner have identified the consumer experience as a key driver of success for health plans. And health plan executives echoed that sentiment at a recent forum we hosted for thought leaders. The sophistication of what Eliza can do to engage health plan members puts HMS at the forefront of the move by payers to be more consumer-centric in their thinking and their actions.

In addition to the acquisition of the health management and member engagement vertical, we have made numerous investments in our growth over the past year. For a variety of reasons, we have experienced growing pains which impacted our third-quarter performance. We believe the substantial leverage inherent in our business model will be more evident in coming quarters. And we will continue to work as diligently as we can to ensure that progress is manifested in our financial results as quickly as possible.

We are now ready for the first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Nicholas Jansen, Raymond James.

Nicholas Jansen - *Raymond James & Associates, Inc. - Analyst*

I just want to dig a little bit into the organic growth of the business and how we should thinking about this outlook in the future. I think in the third quarter, excluding Medicare RAC, you had modestly negative organic growth. I think the implied guidance for 4Q would suggest flattish or so. So just trying to get a sense of how we should be thinking about the growth profile of the business. I certainly understand the moving parts. But can this business be a stronger organic growth story relative to what we're seeing right now? Thanks.

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Hi, Nick. This is Jeff. I do think we certainly feel confident that the organic component of our business, excluding Eliza, has the ability to grow, and that we can get leverage off of that. We have a scalable business model with core infrastructure in place. So from a leverage standpoint, incremental revenue coming in, we believe will come in at a higher than Company margins -- incremental Company margins.

So from a growth perspective, both in COB and payment integrity side, we've done a lot of work this year to position ourselves for growth. We simply haven't seen it in this quarter.

And then on the Eliza side, we think the Eliza book of business can grow double digits as we move into the next year. And we will certainly get more color on that when we do our guidance in February.

Bill Lucia - *HMS Holdings Corp. - Chairman, President and CEO*

And let me make a couple of other points, because I think it's important. And I'm sure other people say this; but the truth is, in this case, one quarter a trend does not make. And in reality, our COB business -- and I've been at COB almost 20 years now -- every quarter, there's puts and calls. There's a whole list of activities we're expecting third-party payers to complete. There's a whole list of audits we're expecting our clients to approve. And in this quarter, some of those things didn't happen.

Now, typically in COB what that means is they are pushed to the next quarter or the following quarter, but we don't lose them. So it's not a business where the money just goes away. In this case, we settle a -- we complete a settlement with the third-party payer. In the next quarter, we get an increase of cash receipts that we didn't have from those payers in this past quarter. So that's part of the lumpiness in the COB business. It's just that this quarter, we had that; and our yield enhancements didn't hit what we expected, though we do expect to see them in Q4 and Q1.

So our bullishness about the business and its growth potential, and particularly the resonance of our clients we when we go out and talk to our clients, and then understanding the connection between our heritage businesses and Eliza, is very, very promising.

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Yes. And I would say the largest variance to our expectations in the quarter related to COB revenue. Q2 was our highest COB revenue quarter ever, and we experienced an unusual drop in the third quarter. As we discussed on our prepared remarks, most of the variance related to timing delays, and we expect that revenue to [flow] through over the next couple of quarters.

On the PI side of our business, we have made tangible progress in both the number of medical records requested and reviewed, particularly seeing that increase in September and October, which should lead to increased PI revenue as those claims are worked.

And we are continuing to refine the implementation process, which will have an impact both on PI and COB. And then, finally, with Eliza, we are making, we believe, the necessary investments and organizational changes to position the business for long-term success.

Nicholas Jansen - *Raymond James & Associates, Inc. - Analyst*

Thanks for all that color. And then my follow-up would just be on margins. They were actually pretty strong in the quarter, even though the revenue was a little bit light. So maybe just walk me through what -- this kind of sustainable versus maybe some incentive comp being pushed out. Thanks.

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Obviously with results coming in lower than expected, we did have some adjustments in our expected bonus payments that favorably impacted comp expense in the quarter. But we did have some increased stock comp expense as well. And really from that standpoint, we had a number of executives that are approaching age 60 that have significant stock holdings. And based upon our long-term incentive plan, we have to start accelerated vesting on some of the equities. So that hit us in the quarter for several million dollars as well.

I think inherently as we think about the business, though, I think we've done a good job of managing costs with our revenue profile. And with our core cost infrastructure in place, adding incremental revenue for all of our product lines should generate incremental margin above the Company's average margins (technical difficulty) ability to expand margins over time with revenue growth.

Nicholas Jansen - *Raymond James & Associates, Inc. - Analyst*

Thanks. I'll hop back in queue.

Operator

Jamie Stockton, Wells Fargo.

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

Maybe first on the program integrity business, how much of this, if you can try to quantify it for us, is getting contracts live, which you guys have talked about being an issue for a number of quarters? And I think that it's hard, I think, for a lot of people to understand, like, why that would continue to be an issue for such a long period of time; versus health plans just not wanting to put the screws to providers with more aggressive audits in what might be an environment where utilization is weak, and mix is shifting, and providers' fundamentals don't look very good? So can you help us understand how those two things are impacting the ramp of that business relative to each other?

Bill Lucia - *HMS Holdings Corp. - Chairman, President and CEO*

Yes, thanks for that question, Jamie. It's Bill. I'll start. Let me address ink to green, because I know this is a frustration for our investors, and clearly a frustration for ourselves as well. We really did -- this year, we did work hard to have faster implementations and to significantly increase our quarterly capacity, but we just didn't make as much progress as we had planned. So we have done a top-to-bottom, double-down on a review of every operational step from the time we sell a piece of business through to the time we actually generate our first dollar of recoveries or revenue, and a complete review of our data ingestion engines, our proprietary systems, our analytics. All of that has been done.

We now have a roadmap to move forward on a more accelerated basis, and are making the necessary investments in the specific spots in the implementation process that we have to make. And some of that is putting some more sales engineering efforts up front so we are lockstep with the clients instead of experience some of the client delays we have.

On the other part about the payers not wanting to irritate the providers and being concerned about that: look, we live with that all the time. I don't know if it's at a heightened state at this point. I think it's always been an issue and it ebbs and flows for a lot of reasons. If a payer is very concerned about provider Net Promoter Scores, if there are specific providers that they exclude from audits because they are negotiating with them. There might be a Medicaid agency that doesn't want us to audit a children's hospital on a specific quarter.

Those happen all the time. Interestingly, even though you talk a little bit about depressed utilization, for our Company year-over-year, if you just look at gross claim dollars coming through our ingestion engines, they are up pretty significantly. So that to me is a leading indicator that the growth profile -- organic growth profile of our business is continuing, and will continue to be strong. We will rebound from this quarter.

I'll let Jeff give a little more color on PI because we have been digging deep into it. At the beginning of the year, we put Doug Williams over it. And he has done a complete top-to-bottom review, reorganized the function to accelerate that product line.

But Jeff, do you want to give a little more color on it?

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Yes. I think a couple points. I would say to one of Bill's key points, we haven't seen any diminished demand from our customers on doing the PI work that we do. We did have some specific instances where, I noted in my prepared remarks, short stay audits; we did some large ones last year, and those weren't repeated this year. So there's an individual specific area that we've had ebbs and flows in. But we also have other customers signing on short stay audits, which continue to be good audits for us.

But the PI products are just much more complex to implement than COB contracts and they just take longer before they are revenue-producing. Factors include client collaboration, availability of IT, and other customer resources that are critical factors in the process. But as Bill mentioned, we've reengineered our entire PI implementation process, including the development of new PI edits, getting customer approval to implement the edits, assisting with provider notifications in order to minimize network abrasion.

And I think finally, for us, just with the amount of work that needs to be done, we have really dissected the whole implementation process kind of by buckets of time, and have individual groups of individuals working to reduce each of those buckets from pre-contract signing, to getting data, to working with the data, developing edits, and getting our work done on the back side once we get the data. So I think we have done a comprehensive review.

As I said in my remarks, we have seen both the number of claims being reviewed go up quite a bit, and the number of medical records we have requested increase quite a bit over the last several months. So I think we're seeing that. But we also had this 90- to 120-day lag as we do work for it to start producing revenue.

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

Okay. And then maybe just two quick follow-ups. One, the 2016 bookings from program integrity seems wrong. Can you just clarify whether that stuff has gone live at this point, and really what we're talking about trying to get live is stuff that's been booked in 2017? And then --

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Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Yes, I would think -- I'm sorry, Jamie. Go ahead.

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

Well, the other one was just if you could actually quantify how much incentive comp was maybe reversed in Q3, just so that we have some sense of how expenses are likely to trend in Q4.

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Yes. In terms of reduction, there was about a $2 million-plus reduction in incentive comp in the quarter. And --

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

And then whether all the PI bookings from 2016 have actually gone live at this point.

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

No. No, they haven't all gone live. In fact, I would say on our -- on the large sale we announced in mid-2016, that's really now starting. We expect that to be producing revenue on the commercial side in the fourth quarter of this year. So that was a large national account. It was very complex, a lot of -- we had to work through a lot of provider exclusions and complexity in getting that up. And so, again, that was one we expected would be hitting in both the second and the third quarter. It now will start producing revenue in the fourth quarter.

And so I'd say our overall implementation queue has actually grown. So as we have continued to sell, our implementation queue has grown. So we still have some from 2016 that are flowing through the process, and certainly the sales in 2017. And so, as we think about going into 2018, the focus is on adding resources and continuing to refine that implementation process to do those quicker, and that will be part of our revenue growth in 2018.

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

Okay, thank you.

Operator

Sean Dodge, Jefferies.

Sean Dodge - *Jefferies LLC - Analyst*

Jeff, on the last comment you made there about the implementation queue growing: your new commercial sales in the quarter, the mix of business you signed, inverted. It's usually about two-thirds coordination of benefits, and now it's about two-thirds program integrity and analytics. We also saw a pretty big number of lives involved with over 19 million. Is this signaling some traction you are getting with the newer care management offerings, or is it particular strength in PI? Looks like the business you signed during the quarter was pretty encouraging. Anything -- any color you can add there would be helpful.

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Of the 19 million we had, we signed some -- a good-sized PI contract with a large national plan to do some new types of audits that we haven't been doing recently. So that certainly was a driver. But I'd say the mix between COB and PI can fluctuate from quarter to quarter. We've seen more of the growth coming from PI. I think, again, going back to that we haven't seen a diminished demand for PI products. I think for us it continues to be about how we execute that and deliver results to customers. And if we can do that successfully, and we certainly believe we can, we'll continue to see growth in that piece of the business.

Sean Dodge - *Jefferies LLC - Analyst*

Okay. And then both you and Bill mentioned Eliza deviating a bit from historical norms and not getting the step-up in revenue you expected in the quarter. Have you been able to put your finger on specifically what happened there? And is it similar to COB, where that's more of just a timing issue, you think? Or is this, in this case, something a little bit more structural or systemic?

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Yes, again, I don't think we've seen a fundamental change in any of the demand characteristics of the market. I think we're going through what we'd characterize as just some normal integration work. We did have some of the sales team that have left or that we have asked to leave as we moved into the Eliza operations. And so we've had to rebuild some of the sales operation. We did put an HMS executive in charge of that as well as some of our other care management sale operations. So we've got kind of a one executive kind of leading the charge on the sales of that.

Bill made some remarks on this from his standpoint. He can certainly add to this. But I would say, based upon our client interactions so far, we're receiving very positive feedback from our existing legacy HMS customers on what the Eliza service offering can provide. And so I think we're excited, as we go into 2018, about the prospects of Eliza and pairing it up with our Essette care management platform, and also pairing it up with our member health profile risk stratification product we've talked about. We think we have a fairly comprehensive approach that we can go to market with, and we're starting to get traction on that.

Bill, I don't know if you want to add anything to that.

Bill Lucia - *HMS Holdings Corp. - Chairman, President and CEO*

Yes. I mean, look: I think there's macro trends that are clearly in our favor with Eliza. There's just the growing importance of quality measurements across the board in Medicare and Medicaid as financial incentives for health plans. And so, closing gaps and improving outcomes is critical. This increased emphasis on care management for the at-risk community -- so again, the government programs and commercial at-risk -- that many plans are really taking an interest in how do we become more consumer-oriented.

Remember, the plans traditionally -- their employers were their clients, let's say government was viewed as their client, or the provider. There's been a big shift -- and we heard this from industry leaders -- to consumers being their customers. And how do we start focusing on that? And so Eliza's tools really help them.

And then I would add that member satisfaction is key to retention. And so a lot of our retention programs are seen very favorably in the marketplace.

And then lastly, we've been getting a lot of feedback that all of the -- as you've probably seen, maybe even in your health plan or across the board -- there is wellness apps, there's disease management programs, there's incentive programs, there's a ton of different tools that payers are trying to get members to adopt, particularly in the Medicaid space, to be able to improve outcomes.

They're starting to see -- and even these vendors that produce these applications -- Eliza as the tip of the spear to drive more enrollment or utilization and adoption of the services. And that's a -- for Eliza, I want to say relatively simple; for the rest of the world to do, not so simple. And that's because of our very patented, detailed way to do customer segmentation, and understanding the modality of outreach they will respond to.

So, we're finding new use cases for Eliza as we go to market. We're not happy that it's flat year-over-year. But we are very bullish about the opportunities in the future, and those are things that we're diligently working on throughout the organization.

Sean Dodge - *Jefferies LLC - Analyst*

That's very helpful. Thank you.

Operator

Ryan Daniels, William Blair.

Ryan Daniels - *William Blair & Company - Analyst*

Bill, one for you. I'm curious with the issues you've had with the ink to green initiatives, if it's caused any client turnover or competitive issues. Meaning that you haven't been able to generate the savings for them, as well, and recognize your revenue on the time period perhaps you thought. Is that causing any consternation in the end market or in your existing client base?

Bill Lucia - *HMS Holdings Corp. - Chairman, President and CEO*

Really, no, and let me explain why. I would say, and I'm going to just throw some numbers out here, but more than a third of our implementations are some delay that's caused by our customer. And that's -- they can't get us the right data, the right format. We're still determining with them: what does this field mean in their system versus every other system we work with? It's very complex, right?

So there's a portion where they understand it's a delay on their side. And that doesn't -- they don't really look at HMS and say, well, HMS, your delay. They get it. We're working hard at that to make sure that we understand that much earlier in the sales process, and are probably going to revise our implementation processes in a way where we are not leaving the client till we get it.

The other is, on the ones where we're delayed, in reality we have shortened that time frame. So we've -- in a number of cases have carved 30 or 60 days off of HMS's process. So we've made the most impact on shortening our time frame. So we've not lost any customers through the process. None have backed down and said, stop the implementation, we're not interested. We always have customers who will put stuff on hold because they have competing priorities, even though we generate revenue for them or recoveries.

We always have customers who throw exclusions in, meaning: don't audit this network because we're having a discussion with them, or we want to be particularly sensitive to them. Those are unforeseen, but we've not lost any business to competitors. And net-net, we're still adding to the customer base, which, again, I think bodes very well for the future. Now we got to through the backlog in a more -- even more aggressive manner than we have in the past, and the entire executive team is focused on doing that.

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

And the only thing I would add on that is different companies doing payment integrity work have different levels of areas that they focus on an expertise, so there's always a range of different types of audits and success you could have. Because not everybody is focusing on the same type of audit, so there's always that driver in the marketplace as well.

Ryan Daniels - *William Blair & Company - Analyst*

Okay. And then I want to ask a follow-up to Jamie Stockton's question, maybe just a little more explicitly. We have seen, clearly, managed care doing well and healthcare providers not doing well, with utilization being lower. So I'm curious specifically if you think, given that you saw weakness pretty much everywhere -- both COB, program integrity, and Eliza -- is there just less urgency than normal in your client base to do these audits because they are already seeing good profits because they might already be at MLR ratios, such that further improvement doesn't benefit them on a one-to-one basis, things of that nature, so that we're going through a little bit of a transitory headwind as well? I know that's hard to predict, but I'm curious of what your thoughts are on that specific topic.

Bill Lucia - *HMS Holdings Corp. - Chairman, President and CEO*

So Ryan, let me start, and then I'll have Jeff add some color. As I mentioned, the gross claim dollars and number of claims coming into the Company, from this time last year to this time this year, have increased significantly. Now, part of that is obviously we have added more clients. Because we're heavy in the Medicaid managed care space, our clients have added new states. But net-net, we are seeing more dollars flowing through our systems.

On COB I'll remind everybody, it's federal law. So it's not like a client can say, you know what? Don't pursue these third parties. Because their audit -- the state is audited by the feds; the plans are audited by the state. So you have I think it's 90 days from the date you identify a third party that you have to begin pursuit of recoveries.

So, on the COB business compared to payment integrity -- and this is what I think set us apart -- on the COB business, it is regulatory, it's mandatory, and you have to pursue the dollars. And, in fact, there's legislation sitting in Congress to put even more teeth into that.

So I don't think you'll ever see -- again, like I said before -- quarterly there's put and calls. This quarter, we didn't have -- we had the same (technical difficulty) that we're bullish about of things to happen that just didn't happen. That stuff is going to move into Q4 and Q1. I'm confident about that.

I think PI is a little different. I think some of the factors you brought up may exist in PI. But I got to tell you, we've not had any clients come to us and say, oh, you know, our MLR is better, don't do recoveries. And we're actually, on the state side, our -- there's a number of our Medicaid RAC accounts that are growing.

So, I would say that on a PI perspective, we really haven't seen the general pushback. It's the same, typical, don't audit this network this quarter; or we're going to put it on hold because we're getting some things together with our systems; or they are putting in a new measurement system, because they have all -- all the vendors work with one -- what's called a tagging system, so that we go in and tag claims.

But Jeff, do you want to give some more color on that?

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Yes, I only have a couple other comments to add. So for both managed Medicaid and Medicare Advantage plans, they are competing with a fixed capitated amount of premium dollar they're working with. And so I think they are always going to be looking to try and optimize that. And utilization and claims costs can fluctuate for them, as well, and can -- over time. So I don't think we've seen that diminish any demand.

And then on the commercial marketplace, particularly -- roughly half of the commercial marketplace is ASO. ASO, self-insured, large employers, now they're utilizing the health plans to do this work. And we're just seeing growing interest from some of the channel partners we're working with to go after that business and actually provide more services from the payment integrity side, really benefiting directly the large employers. So those benefits would be going to the large self-funded employers, and there hasn't been as much activity, particularly in the payment integrity side, for that component of the business. And we do see some growing opportunities there.

Ryan Daniels - *William Blair & Company - Analyst*

Okay. Thanks for the color.

Operator

Mohan Naidu, Oppenheimer.

Mohan Naidu - *Oppenheimer & Co. - Analyst*

Bill, Jeff, I just want to go back onto Eliza a little bit. I understand the sales disruption there. Was there any disruption to the existing contracts that impacted your revenues? And was there any disruption to the day-to-day operations that might have caused any customer attrition in that business?

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

No, Mohan, there really hasn't been. A good -- a sizable chunk of the Eliza business is a SaaS model, a recurring revenue model, component of the business. And that's -- we like that aspect of it. It's revenue diversification for us. It tends to be pretty sticky because it includes comprehensive targeting for customers, as well as comprehensive outreach programs for them. A lot of the transactional work is -- we tend to do it each year at the same time for large national customers and regional and smaller plans as well. So there's really been no operational disruption.

And I think other than we've characterized, just kind of the normal challenges of just bringing two companies together and the cultures and just working through those, I would all characterize that as fairly typical. But no major losses of customers that have impacted results up to this point.

And, actually, I would say we've had significant outreach to legacy HMS customer base; and really, I think, seeing good traction to sell the Eliza platform into our existing customer base.

Bill Lucia - *HMS Holdings Corp. - Chairman, President and CEO*

I think the other thing I would mention is we did sign a large national Medicaid plan for Eliza. That plan, and in fact most of our large national Medicaid plans, bring the accounts up, whether it's PI, COB, or Eliza, state-by-state. And it took longer to ink the master services agreement than we had thought. So we will now be rolling that out market by market for them. We had expected that to come in faster than -- or get resolved faster than it had. So now that we will be able to roll that out market by market, we will have even better success stories for that client than the first state that was implemented.

Mohan Naidu - *Oppenheimer & Co. - Analyst*

Okay, got it. Maybe just following up on that one. Does the disruption that you are seeing with Eliza -- does it change your view or pace of acquisitions that you might do in this area?

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Yes, again, I wouldn't characterize it as disruption. I would characterize it as just normal integration work that we're doing. It's the second acquisition that we've done in the last five-plus years. I think we did a lot of due diligence on it and we had a lot of people involved. As Bill said earlier, nothing has changed our excitement about the acquisition based upon our contacts with customers, the product suite they deliver, or the value proposition that they bring to both HMS's product suite and to our existing customers.

So, I think it's our second one. We're getting better at it. We're building the muscle and the playbook to actually bring in additional acquisitions. So I don't look at it as anything other than normal challenges that we're working through. And again, as we continue to build liquidity, I think we will look to deploy that liquidity strategically going forward. And M&A is going to remain a top priority to help further complement our existing product suite.

Mohan Naidu - *Oppenheimer & Co. - Analyst*

All right. Thanks a lot for taking my questions.

Operator

Richard Close, Canaccord Genuity.

Richard Close - *Canaccord Genuity - Analyst*

I was just wondering if you guys can quantify the backlog at all, in terms of -- I mean, what the -- maybe an estimate of annual revenue contribution is in the backlog, and how that's changed.

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

I would say -- we haven't put a dollar value on it, Richard. But our backlog, as we look at 2016, where we finished 2016 and where we're at today, it has grown 25% to 30%. So, I would say again that we continue to see sales success. And as we add resources and really focus on the things that Bill talked about, we know from our backlog how many are relate -- what clients are on hold for client-specific issues, what clients are on hold for any HMS issues. And we're really targeting specific action plans to drive faster resolution of those issues to increase the throughput.

Bill Lucia - *HMS Holdings Corp. - Chairman, President and CEO*

And Richard, let me just add a comment on that, too. Obviously we have both the number of implementations, the number of re-implementations -- how many are new logos? How many are up-sells? What type of products are embedded in it? And we do have annualized revenue expectations and total contract value tied to it.

The challenge is the things I've said before, which is why we don't like to give the actual numbers. By the time we implement, a client could say, don't audit this network; or now we want to limit the scope to X; or it will take longer to get this up and running; or we now want you to roll this out market by market; or I need plan presidents in each one of my states to approve it. And so, it's very hard to give that -- if we give you that data, then, while we're bullish about it, we know that all of those things can happen.

So I think the basic comment that the queue is 25% to 30% larger gives us the reason to be bullish. We have to work through that queue and work through all those individual client idiosyncrasies that we can make sure get done, and we're continuing to push them hard through that process.

And I think we have learned a lot through this. I think what we have learned, and are taking the biggest steps on right now, are how do we pull more sales engineers and subject matter experts into the sales process as early as possible to lock this up, so that we don't have surprises as we go through implementations.

So that's a reason why we don't talk about the dollar number in backlog.

Richard Close - *Canaccord Genuity - Analyst*

Okay. So, given that, do you guys think you need to take a step back? And based on a lot of those challenges or nuances with respect to new business and when it comes on, do you need to take a step back and change the way you forecast your business and provide guidance to the Street?

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Yes, I think that's fair. I think as we looked at some of the specific issues that happened this quarter, again, we think a lot of it is just timing-related, Richard. So I do think sometimes that's a little bit harder to predict. But as we go into 2018, we certainly are focusing on what drives our revenue growth, and making sure that -- I think we're prudent in how we forecast and budget that for 2018 and beyond.

Richard Close - *Canaccord Genuity - Analyst*

Okay. And my final question would be on -- just a follow-up on Jamie's. And you talked about $2 million in terms of the bonus reversal. Are there any other puts and takes that we should know about, in terms of as we think about the fourth quarter? Obviously you are not going to get the margin improvement that you targeted year to date. But anything else as we update our models for fourth quarter?

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

The only thing I would call out is we expect another higher quarter of stock comp in Q4 for the reasons I talked about in my prepared remarks. But other than that, that's really all I would call out, that I would expect a similar higher quarter than typical for stock comp in Q4.

Richard Close - *Canaccord Genuity - Analyst*

Okay. Thank you.

Operator

Matthew Gillmor, Robert Baird.

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

Jeff had mentioned some stepped-up IT investments into integrating some of the PI tools. Are there any additional details you can provide there? Will that just be normal course of spending for the business, or something above and beyond that we should be thinking about in terms of modeling?

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

Yes, we're doing a fair amount of detailed work now, Matt, just looking at the IP investments that we could make and how we can simplify our IT infrastructure. So, no dollars I would give specifically now. We're working on that. And we will expect to have more commentary as we give our year-end call. And some of it may be shifting where we're spending some current dollars, as well. But I do think we believe that simplifying some of the infrastructure can help speed our ink to green; also help us reduce costs and actually enhance our yield activity.

Now, we've started that that process, obviously, with some of the big data investments we're making, but that's kind of on the front end in managing the overall data assets that we get. I'm talking more on the operational application platforms that we have more work to do on. I think we're going to be methodical when we do that to make sure we are not causing any disruptions to our core operations. So we could see some increased spend there as we go into 2018, but we will give more commentary as we give our annual guidance in February.

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

Okay. We'll stay tuned for that. And then back on the Eliza issue: I was curious if you had any thoughts or comments in terms of how long it would take for the salesforce to regain some of the productivity. Should we be thinking about Eliza's revenue sort of flattish for the next quarter, and then getting back to where you thought it would be? Or do you think it will snap back sooner than that? Thanks.

Jeff Sherman - *HMS Holdings Corp. - EVP, CFO, and Treasurer*

I think we expect it to be growing as we go into 2018. Again, we will give more specific guidance, but I do think we're getting traction with the customer base. And so I do think we will expect it to be growing as we go into 2018. We will give more commentary on the degree of that as we give our annual guidance in February.

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

Thank you.

Operator

Frank Sparacino, First Analysis.

Frank Sparacino - *First Analysis Securities - Analyst*

My questions have been answered. Thanks, guys.

Operator

Steve Halper, Cantor Fitzgerald.

Steve Halper - *Cantor Fitzgerald - Analyst*

Yes, my questions were answered as well. Thank you.

Operator

Thank you. And I am showing no further questions from our phone lines.

I would now like to turn the conference back over to Bill Lucia for any closing remarks.

Bill Lucia - *HMS Holdings Corp. - Chairman, President and CEO*

Well, I want to thank you all for attending our call. As I said, we're diligently focused on providing the kind of -- generating the kind of financial results we know this Company is capable of. We are bullish about our future and the new product offerings that we're pulling together in care management and member engagement. And we look forward to speaking to you again on our full-year 2017 call in February. 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.
