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HMSY - Q3 2016 HMS Holdings Corp Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the HMS third-quarter 2016 earnings conference call. (Operator Instructions). As a reminder, today's conference call is being recorded. I would now like to introduce your first speaker for today, Dennis Oakes. You have the floor, sir.

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

Thank you, Andrew. And thank you, everyone, for joining HMS third-quarter 2016 earnings conference call. With me this morning are Bill Lucia, our Chairman and Chief Executive Officer, and Jeff Sherman, our Chief Financial Officer.

Earlier today we distributed our quarterly earnings release through our website, HMS.com, under the Investor Relations tab. We also posted an investor presentation containing supplemental information, but we will not make specific reference to that presentation in our prepared remarks.

This call is being webcast and can be accessed via the events and presentations tab on our website and a replay will be available of the call later this morning.

Some of the information we discuss today, including the Company's future expectations, plans and prospects, is considered forward-looking statements under the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements are based on the Company's current expectations and actual events may differ materially from those expectations.

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

All information discussed on this call is based on the information available to us as of today, November 9, 2016, and the Company disclaims any intent or obligation to update any forward-looking statements as a result of developments occurring after today's call except as required by law.

Finally, we may refer to certain non-GAAP measures during the call and our earnings release and investor presentation include a reconciliation of those measures to GAAP. In the Q&A session we ask that you limit your inquiries to one question and one follow-up so we can get through the full list in a timely fashion. We are now ready to begin. Bill?

Bill Lucia - *HMS Holdings Corp. - President & CEO*

I would just like to put aside the national election results and any associated sleep deprivation just for a moment to talk about our quarter.

We now have three quarters of 2016 behind us and are essentially where we expected to be in terms of our overall financial performance. We also have clarity on two issues that created many months of uncertainty: our third-party liability contract with the state of New Jersey; and our work for CMS under the Federal Medicare Recovery Audit, or RAC program.

Additionally, new business opportunities are coming our way as a result of two occurrences we could not foresee when the year began: the acquisition we completed in the third quarter of the Essette care management platform; and the award we received in the second quarter as one of seven unified program integrity contractors, or UPICs as they are known, to work with CMS over the next 10 years to combat healthcare fraud in Medicare and Medicaid.

With that year-to-date overview as a backdrop, I will focus my time this morning on the fundamental strengths of our business, while also highlighting some of the strategic steps we are taking to leverage our assets -- our data assets, our customer base and our scalable business model.

Our coordination of benefits and payment integrity work on behalf of over 250 health plans and our Medicaid third-party liability and related work with 45 states gives us unparalleled access to claims and eligibility data.

As of the latest CMS reporting period, which closed on August 31, our customer database includes approximately 91% of the newly enrolled in Medicaid [lives] that have joined the program since the beginning of the October 2013 Medicaid expansion resulting from the Affordable Care Act.

As the agent for state Medicaid programs we also receive eligibility data from hundreds of health plans nationally who are not customers of ours. It provides us data in order for HMS to complete our COB work for our state and Medicaid MCO clients. Together with data we receive directly from our customers we estimate our health plan database to include eligibility data for roughly 90% of the covered population in the entire nation in both private insurance plans and Medicaid programs.

As our state government and commercial health fund businesses grow, either adding brand-new lines or selling incremental products to existing customers, we continuously add to the valuable collection of data we have built over the last 30 years.

Through the first nine months of 2016 we added 17.2 million new lives to our commercial health plan customer base, which in total lives over 100 million for the first time earlier this year. We also sold additional products to almost one-quarter of that population, 24.4 million lives, including 10.8 million in the third quarter alone.

Roughly 60% of new health plan sales this year, based on projected revenue, are for payment integrity products where we are relatively underpenetrated compared to our COB business. The following comments provide a sense of the momentum our commercial health plan sales team has generated so far this year.

Total sales year-to-date for contracts that are typically three years in length are substantially ahead of where they were in comparable periods last year. The total value of individual contracts is running significantly higher than the average contract size in the first nine months of last year, so we are making bigger sales.

And finally, the large national plans continue to buy relatively more of our products compared to the balance of our health plan customer base, which is a significant driver of overall sales [growth].

Though incremental sales are less robust than the state government business, because it is such a mature market for HMS, they continue to be a stable and predictable source of revenue and earnings, particularly now that the New Jersey contract is fully executed. That new six-year contract, which was signed in mid-September, includes a four-year base and two one-year renewals to continue the TPL subrogation work we have done for the state for 30 years.

We have spoken previously about the Massachusetts TPL contract which was scheduled for rebid this year. We do still expect the RFP to be issued before year end, but it now seems unlikely that the bid process could be completed by December 31, so we currently expect our contract to be extended.

Though our largest and higher profile state customers have been the focus of attention over the last two years, it is important to remember that we have a very broad base of state accounts for whom we do a variety of work all across the nation. Government work is almost always competitively bid, so our state proposal teams are in constant motion.

Occasionally we are able to add services under existing contracts as we have done in recent months with the state of Florida. And in addition to New Jersey, the third quarter included notice of a TPL contract award in Missouri, a Medicaid RAC contract in Wisconsin, and award for the subrogation work we do for the North Carolina state employee health plan, a new three-year contract for the state of Maine for credit balance and long-term care audits, and a new RAC contract in Colorado.

In some states all of our services are bundled into a single contract while in others we have multiple contracts. In both cases contract extensions, either formally agreed to with the initial contract term or at the convenience of the state, are a very regular occurrence. In the third quarter alone 10 of our state customers extended contracts for a range of services including utilization review, RAC auditing, pharmacy COB, child support and TPL services.

Though our base case continues to be low-single-digit growth in our state business for 2017 and beyond, we do have innovative programs in the early development stages that can bolster that growth profile. We also believe our newly acquired care management and coordination solutions are applicable to the state market. And finally, any further Medicaid expansion would be a plus for HMS.

But our real growth engine presently is the commercial health plan business, which now includes other risk bearing entities with our acquisition of Essette. Health fund revenue in the third quarter of $59.2 million was a quarterly record and year-over-year growth through the first nine months of 2016 is just shy of 18%.

Reaching our full-year health plan growth target of 18% to 20% is challenging since we had a particularly strong fourth quarter last year. But we do expect another record high for health plan revenue in the fourth quarter to create a path to achieving our objective.

Our year-to-date experience with our commercial health plan customers is overwhelmingly positive with a single frustration being delays we have experienced in the implementation of new or expanded payment integrity business. As we have explained previously, payment integrity sales present some implementation challenges which can stretch out the timeframe for initial revenue generation.

We continue to do everything possible to avoid or reduce implementation delays but still must contend with customer actions beyond our control. A good example this year is one large national customer who initially indicated their intent to resume short stay auditing at the beginning of the year, but delayed doing so for six months so the first dollars of revenue did not come until September.

And in the last quarter four planned implementations which we expect to produce roughly $2 million in third-quarter revenue were pushed into the fourth quarter as a result of customer actions or in-action. As a result payment integrity revenue through the first three quarters is below where we thought it would be when the year began.

On the other hand, our health plan COB business has come in stronger than we expected. That outperformance is a reflection of the ongoing investments we are making in the COB product line. Even though it is our heritage product line there are still opportunities to improve efficiency and [yield] for innovation and technology.

18 months ago we faced different implementation challenges which were the result of sales outpacing our internal capacity to efficiently implement what we sold. Our ink to green initiative, which focused initially last year on COB and began tackling PI implementations earlier this year, has considerably reduced that gap.

We entirely reorganized the process and added resources such that customer implementations through the third quarter of this year are up about 20% compared to the first nine months of last year. And the time from signing to revenue production for various products has been cut an average of 20% to 30% across the board.

Though delays in data onboarding have previously been the toughest implementation barrier to overcome, we are investing in new technologies which are dramatically improving that part of the process. We also continue to partner with our clients to find better ways to import their data more quickly and in the cleanest and most secure fashion so it is immediately actionable.

Today roughly 90% of HMS revenue is generated by our state government and commercial health plan businesses with the balance being the Medicare RAC program and several federal contracts and other clients.

As announced last week by CMS, we were awarded one of the four Medicare RAC Part A and B regions; it is the same Western region we operated in previously with four mid-Atlantic states added so all of the new RAC A and B regions are roughly equal in size.

Given the history of the program and our expectation that it is unlikely to return to the same level of [auditing] which CMS permitted a few years ago, we are quite content to be a participant in the one region we had under the prior contract. The (inaudible) we bid was based on the limited quantity of claims that can be audited as described in the RFP and the elongated payment terms.

We are happy to continue our work as a RAC auditor and to apply our expertise preservation of the Medicare trust fund. We intend to do so, however, while maintaining a reasonable margin and not over investing in what has been such an unpredictable program for the past several years.

Separately, we will also continue to partner with CMS on their front prevention work under the UPIC program and through our role in the fraud prevention partnership.

Before turning the call over to Jeff, I do want to highlight the very important and exciting acquisition we announced in September. The Essette Web-based care management and care coordination platform is designed to help risk bearing healthcare organizations identify, engage and manage at risk populations and to improve health outcomes for their members while managing cost.

The acquisition was consistent with both our plan to prudently invest balance sheet cash and begin building out a broad foundation of technology and service solutions designed to help our customers better manage quality, cost and compliance across all of their lines of business.

In addition to the technology we acquired we are very excited to have the talented individuals on the Essette team as part of the HMS family. They have embraced the opportunity to sell their products on our larger platform and they will be a tremendous asset as we look to build out our care management and analytics portfolio.

We see the Essette product suite as a meaningful cross sell opportunity both with our commercial health plans and state government customers as all payers face mounting economic pressures and the payment system inches closer to more value-based reimbursement models.

We believe we are entering this market at an inflection point as our clients increasingly realize the importance of better managing the sickest population, many with multiple co-morbidities.

Numerous studies have shown that a small percentage of Medicaid and other populations drive the vast majority of all healthcare costs. We believe our ability to provide the tools to identify and effectively manage high utilizers using HMAs data analytics and the Essette platform will be an attractive offering to our customers.

We intend to invest in the Essette platform directly to enhance the scalability of [short-term] and we are actively looking at a number of other businesses that would be immediate plug-ins or otherwise good complements to our evolving care management technology platform.

Jeff will now provide his perspective on the quarter just completed and add some additional color on our plans to close out 2016. Jeff?

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

Thank you, Bill, and thank you to everyone who is listening to our call this morning. I want to begin by echoing Bill's view that our 2016 year-to-date financial results are encouraging, both in terms of the fundamentals of our business and the key strategic objectives we established as the year began.

With the RAC contract awards announced last week all of the issues which have been a distraction for many observers of HMS over the past two years are now behind us. We have seen a shift of focus in recent months among those who follow our Company to the fundamentals of our business, its growth trajectory, scalability, cash generation and potential for expansion through acquisition and we heartily welcome that change.

Before getting into the details of our quarterly performance I do want to explain the tax benefit we identified in the quarter which will reduce our effective annual tax rate by about 300 basis points to approximately 37%. This is obviously a very positive development which will impact both cash flow and net income.

Recognizing that 40% was high, we engaged an outside consultant to help us identify strategies to optimize our tax rate. The result of our work, which was concluded in the third quarter, was the identification of certain research and development tax credits and domestic manufacturing deductions to which HMS is entitled. We will utilize those benefits in 2016 and going forward, but have also applied for refunds in connection with the previous four open tax years of 2012 through 2015.

We ordinarily do not provide revenue estimates by customer group on a quarterly basis as the year progresses, but given the number of moving parts we have had I think it is prudent to provide a framework for expectations about our fourth-quarter performance.

On our second-quarter call in August we projected an average quarterly run rate of approximately $55 million for state government revenue over the second half of the year. Third quarter came in slightly below that level at $53 million, but we expect the fourth quarter will be $3 million to $5 million higher primarily due to yearend work done annually for some of our state customers.

As Bill mentioned, our third-quarter commercial health plan revenue was a record $59.2 million, but the previous record was set in the fourth quarter of last year at $58.5 million, so we will need sequential growth of approximately $10 million to reach our full-year growth target. We have good visibility and revenue expected from a number of implementations schedule throughout the fourth quarter which will generate incremental revenue compared to the third quarter.

In addition, it is very reasonable to expect the usual yearend push from our commercial customers for additional savings, though the magnitude of that work is difficult to estimate with certainty. Last year we had approximately $5 million of one-time commercial health plan projects in the fourth quarter and our current forecast assumes a similar level this year.

With our customers' interest in maximizing their savings fully aligned with our goal to finish the year strongly, we continue to believe we can reach our year-over-year health plan growth objectives.

We are still completing the budget in the planning process for next year so we'll not provide formal 2017 guidance until our fourth-quarter call in February. Considering, however, the strong year-to-date sales, the staying demand for our products among the nation's largest health plans and the added tailwind of macro healthcare environment where enrollment and expenditures are expected to grow exponentially over the next decade, we continue to see that commercial health plan business as a high-teens grower next year and beyond.

Medicare RAC revenue was higher than expected in the third quarter, but almost all of that related to reconciliation and continued invoicing activity on certain recoupments as the contract was winding down. We do not anticipate any meaningful level of auditing in the fourth quarter under the new contract announced last week even if it is finalized before year end, but to expect to have a better sense of the RAC revenue opportunity when we give 2017 guidance in February.

Two items of note on the expense side last quarter include fees related to the tax project, M&A and other consulting fees which together totaled approximately $2.1 million. Both are included on the SG&A line of the third-quarter income statement.

Operating cash flow in the quarter was consistent with our expectations. Principal uses of cash in the quarter included approximately $21 million for the Essette acquisition and a stepped-up level of capital spending compared to the first half of the year totaling approximately $9 million. We expect a similar level of CapEx in the fourth quarter as we continue to invest in IT infrastructure and expand IT capabilities.

The September 30 balance sheet reflects the Essette acquisition with approximately $17 million added to goodwill and approximately $4 million related to intellectual property, customer list, etc., which will be amortized over various time frames. Even with the Essette expenditure we ended the quarter with a healthy cash balance of $171.5 million.

Our primary capital allocation focus continues to be acquisitions to complement our core business, expand our data analytics capabilities, particularly in connection with the newly added care management platform, or add to our capacity to detect fraud. Our pipeline of acquisition opportunities remains quite full and we are meeting regularly with potential strategic partners and target companies.

We intend to maintain our discipline but also aggressively pursue the deployment of capital to acquire assets which will help us better serve our customers and incrementally grow our business. We continue to see our balance sheet as a good source of inorganic growth and, based on the diligence we have conducted over the last 18 months, we remain confident we can prudently deploy capital in a manner similar to what we achieved with the Essette acquisition.

Bill will now have concluding remarks and then we will be ready for questions. Bill?

Bill Lucia - *HMS Holdings Corp. - President & CEO*

Thank you, Jeff. I think it is fair to say that projecting the impact of the election on our business with any certainty is not possible at this very early stage. But we do not currently anticipate any negative consequence.

At this time we believe it is unlikely there will be major changes to Medicaid or Medicare programs which would impact enrollment levels, at least in the short-term. And we have almost no exposure to the healthcare exchanges which have been one of the areas of greatest focus.

Essentially our business is about saving money for the healthcare system which is a notion that should have wide support throughout the political spectrum. In fact, we take great pride in our work at HMS on behalf of our customers and their members, preventing healthcare dollars from being misspent in our cost containment business so money saved can either reduce the overall cost of care or reallocate it to those who benefit from government programs such as Medicaid.

We look forward to expanding our contribution to the healthcare system as we further build out our data analytics capacity for care management and care coordination.

I want to conclude today by thanking all of my coworkers for both their hard work throughout 2016, which produced three quarters of solid financial performance, and in advance for their expert effort during our final push to close out the year by meeting our full-year objective and setting the stage for 2017.

I also want to take this opportunity to thank our customers for their business and our shareholders for their support and confidence in our strategic direction. We are now ready for the first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mohan Naidu, Oppenheimer.

Mohan Naidu - *Stephens Inc. - Analyst*

Bill, on Essette acquisition it sounds like you are getting into solutions that could help the care delivery organizations and providers, which is kind of a different set of customers compared to what you do right now. Can you help us understand what you guys are trying to do there, especially trying to go after a different set of customer base?

Bill Lucia - *HMS Holdings Corp. - President & CEO*

So, it is not that we are directly serving providers unless they are at risk. So as everyone knows, significant number of providers have assumed risk, there's companies that serve helping providers assume risk. But they had the same challenges as a health plan without the same infrastructure at times.

So our goal would be really to serve any risk bearing entity -- could be a provider taking risk or building a health plan, it could be a health plan, it could even be a self-insured employer better understanding the risk that exists within their population and then better managing the care around that risk.

We do believe that -- and the numbers say it themselves -- that it is a small population that generates the highest amount of cost in our nation. And better understanding those members, understanding the co-morbidities between medical and behavioral health and better managing them so they don't fall through the cracks we will have better outcomes and it should impact the system overall.

So that is really our focus. But it is really any entity of scale that is taking risk and would need our [assistance].

Mohan Naidu - *Stephens Inc. - Analyst*

Okay, got it. Maybe one quick question around Medicare RAC. So while we don't know when the revenues are going to kick in, how should we think about the expenses as you ramp up to service those new contracts?

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

So, Mohan, this is Jeff. I mean the core cost infrastructure for the RAC contract is already in place, our IT systems, etc. So really the incremental cost that will be added primarily will just be medical records coders and nurse auditors that will scale up with increased volume. So I think we can scale that up appropriately.

As we have grown in the Medicare Advantage side and the Medicare RAC revenue was declining, we shifted some of those resources over to the Medicare Advantage side. But we will be able to utilize those resources for both the CMS population, traditional Medicaid patients as well as our Medicare Advantage population.

Mohan Naidu - *Stephens Inc. - Analyst*

Okay, that is great. Bill, maybe one clarification there on the new contract. Is this considered the final contract or are any protests expected out of these awards?

Bill Lucia - *HMS Holdings Corp. - President & CEO*

Well, we can't really -- I don't think we can guess about the protest. I do know that CMS' policy is to provide a debrief for bidders that request one and then protests have to be filed timely. So that is all we know at this point.

If there are no protests we would hope that CMS would quickly go into implementation and would start approving a recovery audit scenario so that we can get back to the work that is so important to the Medicare Trust Fund.

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

And certainly from the standpoint of the current states that we are already operating in, we have all the technology infrastructure interfaces in place including with the [Max]. So once we get the green light, particularly for the states we are already in, the vast majority of the region, we should be able to ramp up fairly quickly.

Mohan Naidu - *Stephens Inc. - Analyst*

That is great. Thank you so much for taking my questions.

Operator

Dave Windley, Jefferies.

Dave Windley - *Jefferies LLC - Analyst*

I wondered, Bill, if you could maybe talk a little bit about in the Medicare RAC bidding how you -- or what your strategy was to kind of accommodate the lower claim volumes in the long AR cycle in your bid; i.e. it sounds like more resources to go after a smaller opportunity. And how do you make that economic for yourselves?

Bill Lucia - *HMS Holdings Corp. - President & CEO*

I will start and Jeff may add some color to this. I don't think it was necessarily more resources. We do have the resources that we have been moving back and forth based on opportunities between Medicare RAC and very similar work we do for our health plan business. So there is minimal new investment.

Ours is really based on -- the [fee we] bid was based on the volumes that were outlined both in CMS' memo about the ADR limits as well as the contract and the longer payment terms. And we opted to develop a fee that we felt as we modeled it would provide an acceptable level of margin for our Company. Jeff, do you have --?

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

Yes, I think that covers it. I mean really it was for us, based upon the ADR limits and trying to project the volumes of audits that we could do, how could we achieve a reasonable margin. And we based upon the costs we had and the volume of work we bid to get to that reasonable margin, including cost of capital for the elongated payment terms.

Dave Windley - *Jefferies LLC - Analyst*

Okay. And I gather from your answer you are not willing to put a percentage on that?

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

In terms of the margin we don't provide customer (multiple speakers).

Dave Windley - *Jefferies LLC - Analyst*

Well, in terms of the contingency fee is what I was -- I think we thought 9.5% on the old contract; I am curious what it would be on the new.

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

Well, the contingency fee is public; it is a blended rate that was over 17% for HMS. So it is a blended rate of four components including CMS referrals, complex and automated reviews as to individual categories and extrapolation.

Dave Windley - *Jefferies LLC - Analyst*

Okay. All right, fine.

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

So the fee is published on the CMS website.

Dave Windley - *Jefferies LLC - Analyst*

And that reflects an accurate blend of what you think your volumes would be across the various subcomponents?

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

That is correct based upon what we know today.

Dave Windley - *Jefferies LLC - Analyst*

Okay, all right. And then second question. On the tax impact your press release outlines kind of two different items, the $1.1 million and the $6.2 million. And then as you're later in the release discussing kind of the impact to the adjusted number in the quarter the text highlights the $6.2 million. I guess I am wondering what the difference is between the two amounts, that they are not both kind of call outs relative to the GAAP versus adjusted.

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

One was just related to the prior year work and one was related to the current year tax impact, Dave, so that was the primary reason. We were really trying to isolate the prior year favorable impact and just called out the current year impact separately.

Dave Windley - *Jefferies LLC - Analyst*

Okay, and the 37%, that is your sustainable tax rate into the future beyond 2016?

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

That is correct. That is our estimate right now based upon the work that has been done.

Dave Windley - *Jefferies LLC - Analyst*

All right, great. Thank you.

Operator

Ryan Daniels, William Blair.

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

Yes, I will start with a quick follow-up. Thanks for taking the question -- on the Medicare RAC. Given what we do know kind of the audit limitations, the payment terms, your contingency fee, do you have any view -- and I am not asking for 2017 contributions, maybe the timing is uncertain -- but a view of when it ramps up, what the quarterly run rate sales might look like for the organization?

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

Yes, Ryan, this is Jeff. I think that is still going to be dependent upon CMS approval of RAC audit scenarios. So we are going to still have to continue to submit RAC audit scenarios. So I think we are going to look to get more clarification on the pace and speed of that, number one.

And there is still the potential to do more audits for providers that have higher error rates and we haven't gotten a lot of additional on that yet. So hopefully we will get some clarity on how that process would work. Both of those will have an impact on how we view the total volume of claims that we could audit.

And it is still -- there is still an opportunity or a potential for change. Keep in mind, the ADR limits being reduced from 2% to 0.5% was an administrative change under CMS. So there is still the potential with the new administration coming in and as they look at potential ways for finding additional savings, particularly to help support the solvency of the Medicare trust fund, that that ADR limit could be expanded.

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

Okay, that is helpful color. So we will still stay tuned. And then maybe one for Bill just on the strong new product sales, especially to existing lives. Can you offer a little bit more detail, are there specific audit types that are in demand? Are those prospective or retrospective? Just any additional color on what is driving kind of the strength there and if there is any common themes among the client based on what they are requesting?

Bill Lucia - *HMS Holdings Corp. - President & CEO*

Well, I can tell you that a couple of the areas of focus clearly are health plans that have decided that they do need to audit short stays. It was a decision by CMS to no longer audit short stays and of course everybody knows the long embroiled controversy with the AHA over that. But in reality health plans don't get to print money and they have to live within a premium band.

So, there is a little more acceptance to roll out short stay audits both in Medicaid and Medicare Advantage plans. And then there is other lines of cost that are growing significantly for them: specialty pharmacy, behavioral health. So it is a very wide range.

But I can tell you that when we do our data monitoring or our [co-validation] or any types of audits we are always finding unique opportunities or our clients are finding unique opportunities that they don't have either the resources or maybe currently the technology to pursue.

And that is really what -- there isn't really I would say a common theme, but I mentioned a couple areas of concern for plans, particularly as they focus on the sickest of the population which are the most vulnerable and they need to identify savings for those members.

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

Yes, and I would just add, again, as we do our work across our state and health plan customers, we have a unique view on providers and how they are acting and how they are operating as well. So where we find opportunities in one plan it can be applicable to other plans.

That is really -- with the large view we have is our unique ability to help provide findings across the system from particularly one plan to another that even the largest health plans still only have a view of their customer database.

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

Got it. All right, thanks a lot for the color, guys.

Operator

Steven Valiquette, Bank of America.

Steven Valiquette - *BofA Merrill Lynch - Analyst*

Let me first say I can also vouch for the sleep deprivation comment you made at the beginning of the call as well. I guess just for us, you talked about implementation delays, payment integrity solutions, I think that has all been pretty well vetted. But just back on the Obama Care, just curious to get your thoughts on just how much Medicaid expansion is specifically tied to Obama Care.

[It looks like] that part could be harder to unwind as part of a repeal. It is all theoretical, but it just curious to get just your additional thoughts on that component at this very early stage just following the turn of events last night. Thanks.

Bill Lucia - *HMS Holdings Corp. - President & CEO*

Well it is still early, right, I mean there hasn't been any real policy that we can react to at this point, and I am sure that the president elect transition team will start to focus on this.

I am trying to remember, but I don't believe that president elect Trump has been negative on Medicaid and Medicare; I mean those are programs that have been around for many years. Might it solve additional Medicaid expansion? Maybe. But we really can't -- I don't think we can forecast that at this point.

I think there has been a lot of discussion about repeal and replace and it is very difficult at this point to tell 20 million of our citizens that they no longer have insurance. So repeal and replace was something that the new administration might think -- may think is more effective, it might be a net positive for HMS. It is just way too soon I think to anticipate what would happen.

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

And the only thing I would add is we have very little actual business from the exchange side of the Affordable Care Act expansion today.

Bill Lucia - *HMS Holdings Corp. - President & CEO*

And that is the most contentious.

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

Yes. So we expect -- there is virtually no impact from the exchange side because we have so little impact in our existing book of business today and that is all I would add to the commentary.

Operator

Matthew Gillmor, Robert Baird.

Matthew Gillmor - *Robert W. Baird - Analyst*

I wanted to ask a follow-up on the commercial sales momentum. I think Bill mentioned that deal values are running significantly above last year. Is the improvement that you are seeing in the sales trends -- do you think that is driven more by internal factors or are there external factors that are also contributing to the commercial sales momentum like the MLR regulations or maybe higher pharma spending at the plan level? Just kind of curious to get your perspective.

Bill Lucia - *HMS Holdings Corp. - President & CEO*

I think it is a little of both. I mean clearly if you are -- particularly if you are a for profit and publicly traded health plan, anything that can impact either MLR or administrative costs depending on where the savings hit the plan and we can impact EPS, which for many of the largest plans I believe we do based on the volume of savings that we generate, that is a positive.

The other is and of course some of it is based on our own internal growth of our sales team, better penetration in our customer base and then also development of new products to better serve our clients. So the new services that we offer of course are innovative, sometimes built in collaboration with a client's request.

So it is both internal and externally driven and I think we will continue to see this. I don't think there is a -- as we said before, there is no silver bullet in controlling healthcare costs in the nation. But payers and other at-risk entities have a choice to do something about it and that is why they hire firms like ourselves.

And I think our pivot -- our slow pivot to include care management and risk analytics is important because that is the next what I would say wave of area that the nation has to focus on.

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

And then on the commercial health plan side as well, as we talked about on the second-quarter call, getting more into the ASO or the employer self-funded plans, we continue to see an opportunity as well for our services in that component of the market.

Matthew Gillmor - *Robert W. Baird - Analyst*

Okay, thanks. And then maybe for Jeff. On the care management acquisition of Essette, can you remind us how much revenue they generate annually? And was there anything that was included for this quarter? Were there some deferred revenues that -- write-downs that offset that? Just kind of curious what the contribution was.

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

Yes, Matt, when we announced the acquisition we said it was sub $10 million and there was a minimal amount of revenue, immaterial amount of revenue because we only had them for one month in the quarter in September. But on an annual basis we said it was sub $10 million.

So a relatively small acquisition, but we do think it is an important foundational step for us in building a broad foundation of technology-based analytics that will help our customers better manage quality, cost and compliance. And as Bill said, their current customer base today is currently at risk providers that are taking risk more in some smaller health plans.

But we think the technology, which was really built from the ground up from an RN case management perspective to help manage care, is easily applicable to the larger plan. And one easy to navigate Web-based technology platform. So we do think we have opportunities to sell into some of our larger customers as well.

Matthew Gillmor - *Robert W. Baird - Analyst*

Okay, great. Thanks for taking the question.

Operator

(Operator Instructions). Frank Sparacino, First Analysis.

Frank Sparacino - *First Analysis Securities - Analyst*

Just two for me. Jeff, first on the expense side of things, this quarter we did see a notable uptick in operating expenses. And just curious was there anything sort of abnormal this quarter? And then what is your view sort of going forward? Presumably as revenue growth continues will expenses continue at a similar pace?

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

So, yes, I did call them out in my prepared remarks. We had a little bit over $2 million in the quarter related to a couple things. Our tax project work that was done and M&A work as well and some other consulting projects we worked through. So we did have kind of a big step-up in costs which we don't expect are going to be ongoing on a quarterly basis. We may have some additional tax work fees in the fourth quarter.

As you look at our operating margin for the year on a year-to-date basis, we did see an improvement in operating margin of about 110 basis points year to date on the operating income line. So we are getting leverage on the expense side based upon the revenue that we are adding.

We continue to see opportunities to manage costs. But we are also investing in further growth as well. So we have added resources for our implementations that Bill talked about and are having success in shrinking that ink to green timeframe which we think will help us grow our commercial health plan revenue.

And we are also continuing to invest in the IT infrastructure and IT resources both from a platform standpoint of ingesting information and how we manage that information, as well from a security standpoint as well. So we are making incremental investments that are having an impact on cost that won't necessarily scale with revenue, but are increases compared to the prior year.

Frank Sparacino - *First Analysis Securities - Analyst*

Thank you. And then just lastly, Bill, is there any way you can be a little bit more specific or sort of quantify some of the commentary you made around the new sales momentum that you guys have?

Bill Lucia - *HMS Holdings Corp. - President & CEO*

Well, I think what we discussed was at the average sales -- the average dollar of the sales were significantly higher than last year year-to-date. So, when I say significantly higher we are talking about they could be anywhere between 20% to 40% higher on average over a total contract value. So we could have a contract that is three to five years. That's mostly what is happening in expansion sales on the health plan side.

We are starting to see the attention in the independent Blue Cross Blue Shield plans which are starting to present a presence in our sales funnel, which as we have said historically they were not a big player in Medicaid, which is of course our heritage. And now those plans are starting to look for other solutions, particularly in their at risk and ASO commercial businesses. And we are continuing to see a higher volume of sales activity. So net more sales in the Q that have closed year-to-date compared to this time last year.

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

And I would only add to that we are talking about we continue to see a significant opportunity and are framing it in a high-teens growth for the foreseeable future. So obviously sales are a big part of that. We are also continuing to work on yield improvement for our existing customers as well, which is a component of that revenue growth.

So there are puts and takes every quarter, but as we think about the long-term trajectory, those sales growth numbers are reflected in our projected future growth rate, which is obviously coming on a higher base each year. So you have to keep climbing over a higher hurdle to maintain that growth rate.

Frank Sparacino - *First Analysis Securities - Analyst*

Thank you, guys.

Operator

Thank you. We have no other questions in the queue, so I will turn the call back over to Mr. Lucia for closing remarks.

Bill Lucia - *HMS Holdings Corp. - President & CEO*

Well, I want to thank everyone for your continued commitment and interest in HMS and the meaningful work we do for the US healthcare system. And we look forward to speaking to you again on our fourth-quarter call in February. Thank you, everyone.

Operator

Ladies and gentlemen, thank you again for your participation in today's conference call. This now concludes the program and you may all disconnect at this time. Everyone have a great day.