3Q'20 Conference Call Script – 11.6.20

Bill Lucia – Chairman & CEO

HMS experienced a solid rebound in the third quarter, with revenue rising 15.8% sequentially from the second quarter and increasing 12.5% when compared with the third quarter last year.

This is a testament to the resiliency of our strategy and ability to deliver strong value for our clients. Our significant financial strength positions us to continue to invest in the go-to-market strategies and product innovations that will fuel our growth through the remainder of 2020 and well into the future.

Our performance was in the midst of the many external challenges continuing to face our nation and the entire healthcare ecosystem. We had another quarter of strong sales growth and an expanding sales pipeline; we released product enhancements and new product introductions; and, we focused on driving further client benefit through enhanced product yields.

As we mentioned last quarter, nearly all of our lower Q2 revenue was related to the effects of COVID-19. At that time, we were confident in our positive business outlook given the improving trends we were seeing. This perspective became a reality during our third quarter as clients began to lift the audit work pauses enacted during the COVID-19 emergency period, and other business lines regained a more normalized run rate. Additionally, we began to realize the impact of rising Medicaid enrollment.

Organic COB revenue growth of 9.0% over last year's third quarter was driven by increases in prospective COB, improvement in claim volumes related to retrospective recovery work, incremental revenue from yield initiatives, and implementation of new client contracts signed over the past nine months.

We believe the underlying market dynamics will continue to be a positive driver for our COB business with Medicaid enrollment trends increasing again in the third quarter in both traditional fee for service and Managed Medicaid.

In addition, states responding to a recent industry survey currently expect Medicaid enrollment to jump 8.2% in fiscal year 2021, with Medicaid spending growth anticipated to accelerate to 8.4%. These trends position us for favorable growth in the fourth quarter and well into 2021.

Payment Integrity revenue also experienced strong growth of over 55% on a sequential basis from Q2 to Q3 as CMS and a number of state and commercial clients began to lift pauses that were in place to temporarily ease hospital administrative burdens during the pandemic.

From a sales perspective, we have seen a significant increase in new and expansion sales in Payment Accuracy in the first nine months of 2020 compared to the same period last year. As a reminder, Payment Accuracy includes both our COB and PI business lines.

Our go-to-market initiatives continue to highlight our significant capability in delivering meaningful and measurable savings for our clients. During Q3, we signed new Payment Accuracy contracts with 14 clients, including six new logos. Based on current implementation timeframes, we would expect revenue generation from these contracts to begin to be recognized in 2021.

Our capabilities are seen as especially important to States facing significant budget pressures due to lower tax revenues and higher Medicaid and unemployment costs. In addition, we continue to scale our Medicare-to-Commercial and Commercial-to-Commercial COB solutions, which are helping to drive incremental revenue opportunities through our concerted cross selling efforts. Year-to-date, we have been able to cross sell Accent services into six of our commercial clients, including Commercial COB and subrogation solutions.

In addition, our annual Momentum client conference this past September generated strong interest in our product capabilities and thought leadership initiatives. Even though this year’s event was virtual, it was a resounding success as we doubled our client attendance and stimulated both lead generation and engagement on industry-wide initiatives.

We also continue to innovate, and are regularly adding new and enhanced solutions to our comprehensive business lines. A key component of our strategic growth plan is to gain a greater foothold in the Medicare Advantage market, which will continue to be the fastest growing segment of the healthcare market.

Our ability to configure our products for Medicare Advantage plans has led to further penetration into the Medicare market. This year we have signed new contracts or executed scope expansions with eight Medicare Advantage plans. Our solution set for this market includes Medicare Secondary Payer premium protection, Part D cost avoidance and recoveries, clinical claims review, payment analytics, and fraud detection and investigation support. Our full suite of Population Health Management services, including analytics, care management and member engagement, also actively address the Medicare Advantage marketplace.

PHM revenue increased from the second quarter, but did decline on a year-over-year basis as we continue to build a stronger sales pipeline and recover from some of our clients shifting focus during the pandemic.

There have clearly been some COVID-19 related timing challenges in our sales initiatives during the second and early third quarter for our PHM business as our client's clinical leaders were focused on the medical response to the pandemic. As the third quarter progressed, we saw sales momentum in PHM, with closed sales in the quarter greater than the first two quarters combined.

During the quarter, we also had three clients go live on our new integrated platform which combines Elli risk analytics with our Essette care management solution. This provides real-time data and information sharing to help improve members' clinical outcomes. We believe the integration of these solutions and the ability to inform member care plans from a continuous feedback loop will enable our clients to better manage medical costs and improve outcomes.

In summary, we delivered a solid quarter of revenue growth and strong profitability in Q3, and we believe there is more to come. Importantly, we maintained healthy cash flows and a solid capital structure that we expect to fuel our growth.

Strong cost containment and clinical outcome capabilities should continue to grow in importance both during and after this health crisis. This will help States in their efforts to close budget gaps as they deal with fiscal pressures due to lower revenue and higher Medicaid costs. In addition, we believe increasing Medicaid enrollment and healthcare utilization trends should be beneficial for our business over the coming months and quarters.

This combination of macro trends, sales performance and product innovation, coupled with our financial strength and business resilience, creates a strong platform to capitalize on the many opportunities for our business.

Jeff will now provide additional details on our third quarter performance and outlook for the remainder of the year. Jeff…

<u>Jeff Sherman - CFO</u>

We continued to execute on our growth strategy in the third quarter while effectively managing our operations and costs in the midst of the pandemic. Our growth has been powered by an expanding product and value proposition, new client wins and contract expansions, a strong financial position and breadth of capabilities that enable us to help our clients meet their most pressing needs.

We experienced a significant rebound with sequential revenue growth from Q2 to Q3 across our business lines. As Bill mentioned, this was due to temporary client work pauses being lifted, the positive impact of increasing Medicaid enrollment, and healthcare utilization rates reaching closer to pre-COVID 19 levels.

COB revenue in Q3 rose 6.7% sequentially from Q2 and increased 20.3% from the third quarter last year, or a 9.0% increase organically if you exclude Accent revenue. As Bill also noted, this performance was led by strong results in prospective COB, improvement in claim volumes and recoveries related to post-payment work, continuous yield initiatives and recently implemented new client contracts.

We expect continued growth in the fourth quarter, and anticipate our COB business momentum will continue into 2021. We may experience some quarterly revenue variability, as we have referenced in prior quarters, but expect the momentum in our COB business to continue in the coming quarters.

Payment Integrity had a significant rebound in Q3, as expected, with PI revenue increasing 55.6% sequentially from Q2 and up 2.6% from the third quarter last year.

During the third quarter, many of our PI clients started lifting the work pauses enacted during the COVID-19 emergency period. However, year-over-year growth continued to be restrained by the lingering effects of COVID-19 circumstances. For example, in PI the Medicare RAC contract did not restart until the end of August, causing a negative impact of approximately $3.5 million. Another $2.5 million impact was related to state RAC contracts that restarted during the quarter or early in Q4. And, the COVID-19 impact to our commercial PI business line was approximately $3.0 million due to client work pauses. We do expect some of this delayed revenue will be recovered in the fourth quarter and in 2021.

PHM revenue also recovered in Q3 and was up 16.2% sequentially. On a year-over-year basis, while PHM revenue declined 11.9%, we expect stronger sales in Q3 will help to drive incremental revenue growth in Q4.

Adjusted EBITDA in the third quarter increased 33.5% from a year ago and was up more than 57% sequentially from Q2. Our results demonstrated strong operating leverage in the third quarter. Total revenue was up $23 million from the second quarter with only a $1 million increase in operating costs. Adjusted EBITDA margin of 26.5% was up 420 basis points from a year ago when you exclude the $7.7 million Gain on Investment in Q3 last year, and was up by 700 basis points from the second quarter.

We recognized Other Expense of $1.1 million in the quarter related to the mark-to-market fair value of our MedAdvisor investment. So this was a $1 million drag on our adjusted EBITDA in Q3 and $0.01 on adjusted EPS versus a benefit in Q2.

Third quarter adjusted EPS of $0.30 per diluted share was up 20% from the $0.25 per diluted share reported in Q3 a year ago, excluding the Gain on Investment in the third quarter of 2019.

Our business is maintaining healthy cash flows and a strong balance sheet, with more than $211 million in cash and total net debt of less than $30 million or 0.2 times trailing twelve-month adjusted EBITDA. This enables us to continue to invest in our product and sales capabilities, support and enhance our IT infrastructure, and advance our internal and external growth initiatives.

Turning now to our financial guidance …

Given our updated analysis of the business, we are maintaining our full year 2020 revenue and adjusted EBITDA guidance. Total revenue is now trending toward the low end of our guidance range of $680 to $690 million. This represents revenue growth of 10.5 to 12.1% compared to last year when you exclude the Medicare RAC reserve release from 2019.

The market environment is still evolving in the midst of the continuing COVID-19 circumstances, and the extent, timing, and duration of COVID-19's impact on our operating and financial performance will continue to be driven by many factors. This includes the length and severity of the continuing pandemic and the related impact on medical utilization, any new client work pauses, Medicaid enrollment, and state budget pressures.

That being said, we currently expect our performance to improve again in the fourth quarter, with momentum continuing into 2021. We recognize our full year guidance implies a sizable sequential increase in revenue from Q3 to Q4, and are confident in our outlook for the remainder of 2020 for the following reasons:

- First, the encouraging, underlying market trends Bill noted earlier, including significant increases in Medicaid enrollment during 2020 and rising utilization and claim volumes
- Second, new client contracts signed in Q1 and Q2 that have been implemented and are now beginning to generate revenue
- Third, our Medicare and State RAC product lines are now running at a full revenue run rate in the fourth quarter, with Accent continuing to ramp up
- Fourth, we continue to have success with yield initiatives in our Payment Accuracy solutions
- And, finally, our fourth quarter is typically our strongest quarter of the year for all three business lines, and we currently expect this trend to continue.

I'd also note that revenue increased sequentially each month during the third quarter, and we view the month of September as a good run rate to grow off of as we move through Q4.

We believe these business drivers position HMS for healthy top-line growth in 2021, especially given the current level of demand for our solutions, the positive trajectory of our sales pipeline, and recently closed sales and active implementations.

Given the expected revenue increase in Q4 and our continued success in managing costs effectively, our adjusted EBITDA guidance range remains unchanged at $177 to $187 million for 2020. This would be year-over-year growth of 7.9 to 14.0%, given the improved operating expense trends now forecasted for the remainder of the year. As with revenue, we are normalizing the 2019 adjusted EBITDA for comparison purposes to exclude $8.2 million from the Medicare RAC reserve release as well as a $7.7 million investment gain.

Bill will now offer some concluding remarks and then we will be ready for questions. Bill…

Bill Lucia – Chairman & CEO

We believe strong cost containment and clinical outcome capabilities are going to grow in importance both during and after this health crisis. This trend, along with the trajectory of our sales pipeline, closed sales and active implementations are all positive indicators of the potential for our future success.

All of these trends make us confident in our business outlook, and we remain focused on supporting our clients and protecting our employees' health and safety. We will continue to invest in our people, processes and technology to sustain future growth and deliver strong client value to meet the industry's evolving needs.

I continue to be thankful for the support and commitment of all HMS employees, and very appreciative of the active collaboration with our trusted clients to drive enhanced value through our partnerships. We'd also be remiss if we didn't continue to thank our nation's frontline healthcare workers for what they do every single day. Thank You!