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HMSY - HMS Holdings Corp at William Blair Growth Stock Conference

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PRESENTATION

Ryan Daniels - *William Blair & Co. LLC - Analyst*

It's my great pleasure to welcome you all to the HMS Holdings presentation. To my right is Bill Lucia, company's Chairman and CEO and to his right Jeff Sherman, company's Chief Financial Officer. I won't go through a lot of details. (inaudible) it's a little bit difficult to find so we'll walk out for the break-out session.

Very pleased to have HMS here at our conference, very interesting organization and one of our favorite names. As of last year, for all of you in the audience as tax payer someone that actually touches you and you may not realize it by reducing fraud, waste and abuse in the healthcare system and driving better coordination of benefits for payers. Also a name that I think it's probably under-appreciated, how big the market opportunity is for HMS and how broad their solution set is into payers and also the exposure that gained in the broader commercial market over the years, which is now about half of their business and growing at a 20% organic cliff.

So, very strong organic growth model, lot of opportunities to sell continued solutions and create value in this market. So, I think a great growth entity to have here at our William Blair Growth Stock Conference once again.

So with that, I'll turn it over to Bill. Required to remind everyone our disclosure is on our website at williamblair.com. And then again lastly, we'll walk down to the seventh floor for the Q&A breakout session at (inaudible). Bill?

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

Thank you, Ryan and thank you everybody for attending our presentation. Of course our first slide is the obligatory forward -- Safe Harbor statement, because we will be making forward-looking statements and our general counsel makes us put this in here.

So today, I'm really going to talk a little bit about our business, our core products, what are really some of the growth drives both in our industry and for HMS and we'll do some key themes for this year, a little brief overview of our first quarter financial results. And then I'm going to add a little bit with why HMS and why now.

So in reality, in a nutshell HMS applies advanced analytics in order to provide payment accuracy services to healthcare payers and we do it in really two broad categories. The one is what has traditionally been called coordination of benefits. It typically applies in the Medicaid space and that's where we're identifying the appropriate party to pay a claim. Medicaid is the payer of last resort.

So, if there's any other resource that pays, it should pay first. We do this prospectively on future claims. So loading information into our client systems so they can direct the provider to the appropriate payer, we call that cost avoidance and we do it retrospectively. So, that's after a claim has been paid and we gather that information and then either bill that to the liable third party or bill it to the provider and take the Medicaid payment back. It's all done on a contingency fee basis, meaning we don't get paid until we have a finding or a recovery and there is billions of dollars of recoveries back to our clients each year.

The second major area in payment accuracy is called payment integrity and that's where we're really looking at the integrity of the claim payment process, and whether the billings themselves were accurate if they occurred in the proper setting, if they were necessary, if there was a clinical reason for actually performing that service, if they were consistent with payment policy and they were properly documented and quoted accurately.

Now all of our services combined are a source of billions of dollars of cost savings and cash recoveries each and every year for the government and for commercial players both in the government risk and true commercial, year in and year out. The key thing about HMS and one of the real barriers to entry is the breadth and depth of the data that we house. It's a significant asset. There continues to be substantial opportunities to use this data-driven analytics that we've built over the years to achieve savings for payers and it's really done through this richness of the data we house.

So, we house historically and current active claims and eligibility information for about 90% of the Medicaid population in the nation. That's a source that is unmatched by anyone else in the industry. And what's interesting about that is the Medicaid population is typically a little harder to manage, they're more of a transient population, they move a lot throughout the organization -- throughout the system in and out of Medicaid and every time that happens it's a transactional event for HMS.

And of course, the demographics of the markets we serve are driving growth opportunity for our Company well into the future and we'll talk a little about that later in the presentation. And then of course as all of you know, the healthcare system in the US just continues to get more complex. And as the system gets more complex, we benefit from that complexity, because not only is there more fraud, but there's just more chance for creating errors for us to identify and correct as a company.

So, our heritage really as a business started in the state Medicaid market, where we established the first service to provide Medicaid coordination of benefits and has been a leader in that market ever since. We operate from large established footprints, a 45-state Medicaid agency in the District of Columbia and they rely on our services, cost savings and recoveries year in and year out.

Now given the procurement dynamics in state government, our contract durations can be anywhere from three years to 10 years. Our average contract today with the state is just over six years, including expansions, which are typically automatic. And then of course we have contracts like our contract in the State of Florida that goes up to 10 years. So they're very long contracts and a long season of selling to be able to upsell to that client.

Now last year, 2015, we had a relatively high year of re-procurement risk meaning, more of our contracts were coming up for re-procurement, that's changed dramatically in 2016. It's a much more limited re-procurement year. In fact, this year we expect contracts re-procuring to represent less than 12% of the last year's state government revenue and our state government revenue is just half of our total revenue. But very little impact to 2016, because the two of our largest accounts, only two of our Top 10 accounts re-procure this year and that's the State of Massachusetts and the State of Ohio.

The State of Ohio's contract; new contract would not be affective till 2017 and Massachusetts expires at the end of 2016. So, really no impact to this year's revenue and then smaller contracts that re-procure through the year. So the 2016 is shaping up to be a very low risk year in our state government market.

We have already started with a pretty busy re-winning season for state business so far this year. We were awarded the Ohio contract with an intent to award we received on May 17th. That is a two-year base contract beginning next July 2017 and it has three one-year options so really a five-year contract. As I mentioned, they're pretty long-term contracts.

And then Louisiana gave us a notice of intent to award on May 20 and that's a three-year base contract beginning July 2016 plus two one-year renewals, so again basically a five-year contract. And what's exciting about Louisiana is it is one of the states that just announced expansion of their Medicaid program under the ACA and then their first week -- I think in their first week of enrollment under the expansion, they added 200,000 net new Medicaid members. So, Louisiana is going to be a growing opportunity for us and Louisiana has been doing this work internally for the last 18 months. So, this is net new for HMS.

And then of course, following our litigation, New Jersey is -- those who followed us, we were in litigation over - that's trade secrets. We settled that, our competitor had to pull out of the market. They had to pull their winning proposal in New Jersey. And so we're in the process of waiting for New Jersey to negotiate with us. Until then, the contract has been extended month to month and it's now extended through the end of June. So, 2016 again is shaping up to be a low risk year for our state Medicaid business.

The commercial health plan business; it is the fastest growing opportunity for HMS. This year, we're estimating another 18% to 20% growth. We had significant growth in our first quarter. We began in this market following our heritage, right. We began with Medicaid managed care and we followed the lives into the commercial health plan segment from Medicaid fee-for-service. Today, two out of every three members enroll in a Medicaid managed-care plan, which we deem part of our commercial health plan business.

We're now providing services to 250 health plans, about 70% to 75% of that comes from Medicaid managed-care with about 15% from Medicare Advantage though that's growing rapidly and then the balance, about 10% from true commercial risk, which would be employer-sponsored insurance exchange risk or directly with employers. As we've said, our footprint is large in the state Medicaid market and it's large in the health plan market with 250 health plans that have been signed since 2006.

We work with both regional plans and very large national. So, 18 of the largest 25 health plans are clients of HMS and then all 10 of the 10 largest Medicaid plans in the nation are customers of HMS. Our sales and revenue diversification efforts have really resulted in 25% of our 2015 health plan revenue and and hopefully more in 2016 coming from non-Medicaid related risk. So that's a big focus of the Company. And just a little historically from a health plan perspective, it was just the last quarter of 2014 that we built out a sales force focused on commercial health plan. So, 2015 was our first full year of really selling directly with the commercial sales team. So we believe we're really in the early innings of growth in this marketplace.

We've got a penetrate and radiate strategy, some of the largest plans in the nation by multiple services from us. They're very sophisticated companies and they know that if we can bring a $100 million to $150 million to their bottom line, add a contingency fee basis, so really relatively no risk to them, we're one of those companies they come to buy additional services.

And in the past, consolidation of health plans have been a net positive for HMS. We believe that's going to continue to be the case with the mega mergers that you've heard about. There's two main reasons; one, we are the most effective provider of Medicaid coordination of benefits services. So if you're a large national plan and you're in Medicaid, Medicare and commercial and you buy another plan that's in those same markets, you don't want to lose that Medicaid coordination of benefits revenue or dollars back to your bottom-line, which is clearly pennies in your EPS, but for some plans it's $150 million to $200 million a year.

So as you're consolidating vendors, you want to keep that and HMS is already integrated with your systems and the other is the risk of security breaches. Last year one out of every three members in the US had a healthcare breach, a healthcare data breach. HMS is HITRUST certified, it's the highest health insurance industry standard for security you can reach. We spent a lot of money to get there. We just were recertified this year and we think that is going to be one of the features that health plans are going to be looking for in the future.

I think this chart just kind of graphically shows, what we've done with moving from a just government risk business to a commercial health plan revenue market. So over the last couple of years, the business the last two years, the commercial health plan business has grown 52%. We're expecting as I mentioned, 18% to 20% growth in this business in 2016. About half of that is anticipated -- the anticipated growth is coming from run rate benefit of new sales that were actually implemented in 2015.

So there is a ramp-up as they go into production. And the balance comes from 2015 sales that are being implemented in the first quarter and second quarter of 2016. And then of course some sales in early 2016 will actually hit this number. The sales queue continues to grow. It's significantly larger in 2016 than it was this time in 2015. And I think what's very interesting for us is, we're having very strategic discussions with these health plans.

With the government -- at least the federal government can print money, state governments have to balance their budget, but we don't have the same value discussion that we have with health plans. And with the health plans, we have very strategic discussions about what are we doing this year and what are we going to do for their bottom-line next year? And it's not uncommon for plan to come to us and say, I need $30 million more from you in the next six months. And at a contingency fee of anywhere between 10% and 20% that's real revenue to HMS.

I think what's important, because we are a data analytics company, is the data that our customers entrust with us and that data is PHI. So as I said, we go to great lengths to safeguard that, we're HITRUST certified, that's critical gold standard certification that we don't believe all of our competitors

have. We now have 1.2 billion current and historical eligibility segments in our database. So, I'm sure that everybody in this room is somewhere in our database. And that's the data that we use historically from 1,100 trading partners can match with Medicaid data to perform our coordination of benefits work. So, we carry unique health insurance coverage for about 160 million lives across our nation.

And then of course given the recovery work that we pursue, we have enormous stockpiles of claims data. As you can see here, it's very significant, probably $40 billion of paid claim records in our active files with much more warehoused. And then of course membership data for Medicare as part of our Medicare recovery audit contract work. And then finally and really important when you're doing audit work is that, we interface with more than 900,000 healthcare providers across the nation, requesting medical records, doing audits, recovering, doing coordination of benefits activity and a lot of this is done electronically.

We're one of the few in our field that uses an electronic provider, secure provider portal, makes the work much easier and that's important when you're taking money back from providers. So it reduces the abrasion in the provider community. We think our data assets are unmatched in the industry and particularly in Medicaid, where our plans in the future are to use that across the entire Medicaid population to find fraud trends and to look at the risk of members who move in and out of the Medicaid population.

So let's talk a little bit about what happened post ACA with few exceptions. Even for those states that did not expand Medicaid eligibility, they did have an expansion due to what's called the woodwork effect. And that somebody going online, checking eligibility to see if they qualify for subsidies under an exchange product and then really finding out that they qualified for Medicaid.

So, in many states, it didn't expand, they saw woodwork effect and growth in their Medicaid programs. And then of course, the average state saw a Medicaid increases of at least 100,000 enrollees or more with some many, many more. Over 90% of these lives are represented in HMS' customer databases. They lag a couple of months after enrollment by the time they get through the state systems and then to our systems. But that mirrors what we said that we have about 90% of the Medicaid lives throughout the system. And some states are still deciding on expansion. As I mentioned, Louisiana expanded this year with their new governor and the numbers have been rich and there's other states that are deciding on expansion to attract those federal dollars to their state.

Let's talk about really what the big opportunity though is for the Company. The addressable opportunity continues to be huge. Across Medicare, Medicaid and private health insurance, we estimate that there is almost $200 billion a year that are paid in there and that's across the base of about $2 trillion of spend. It's significant and it continues to grow because the system continues to become more complex. So, our entire job today is helping the system be more effective by reducing these error rates and either preventing them from being paid incorrectly to begin with or recovering the dollars after they've been paid.

If you look at the annual healthcare spend and the published or derived payment error rates, it really frames the universe for HMS and the total addressable market opportunity going forward and there continues to be an increasing demand for our services, particularly as I mentioned in health plan side where most of our clients are for profit and many are large publicly-traded entities.

The value prop is pretty simple. We have a significant return on investment. All of our clients receive a return on investment of 10 to 1 or higher. And these are really just two examples, one is the national health plan where we saved them $273 million last year. Our fees were $27 million, so a 10:1 return on investment. And then of course the state Medicaid program where our savings were about $100 million, the fees are lower in the state government market. So, we charge them $8 million. They had 13:1 published return on investment. There are just two examples. We've ROIs like this across our customer base and remember our fees are contingent upon finding savings or recoveries. So, it's really a low-risk proposition for our customers.

In light of all of these dynamics, we are pursuing different strategies to fuel our growth in the future. One, we are leveraging this historic Medicaid presence, right. We have -- we're a brand name in the Medicaid market and we're using that Medicaid coordination of benefits to continue to launch us into the payment integrity sphere where we're looking at erroneous payments, particularly with the Medicaid managed care plans.

We have built an innovation center called the Garage and we're producing new products through product innovation and development. We think it's a key competitive advantage just because of the built-up demand from our clients who are looking for more savings. We've hired a whole team

of Six Sigma black belts that are running around the Company with an intense focus on organizational efficiency, rapid conversion, what we call ink to green, but moving from sales to revenue generation and then taking every unit of work that we do and increasing the yield so the dollars we find for our clients and doing out of the lower per-unit cost basis and that's starting to show up in our financials.

And then of course, we have the capacity from a capital perspective to consider acquisitions. There is a great demand from our customer base for HMS to use the sophisticated data and analytics we've built for other purposes for our clients. I think the macro environment is one that's great for our Company and really anybody who is seeking to solve problems in healthcare by cost containment. Expenditures and enrollments are rising dramatically in the core programs we serve. Medicaid enrollment alone is expected to increase by 8.5% over the next eight years.

Medicare enrollment is projected to increase 34% the same time frame. That's pretty significant, of course that's boosted by the aging baby boomers. But the complex enrollment processes and the payment models changing create all of these errors in the system and our ability to use a massive data we've developed and the analytics that we are developing will help us find these errors and correct them in the healthcare system. So, these rising expenditures increase demand for efficiencies and cost savings.

And I think this slide just graphically shows the growth in the expenditures of the programs we serve through the year 2020. And as you can see, the trends continue to require greater pressure on the healthcare system and areas where HMS can excel. I mentioned product innovation, we're doing this both through internal development, but also from the speed to market on an M&A perspective. We recently hired somebody who focuses full time on M&A to be proactive instead of waiting for auctions. And it's really based on, again, leveraging the data and the data analytics we have and this vast footprint of over 300 customers to sell to.

We did develop and will offer two new unique products in the market in the last year. One was Prepaid Clinical Reviews, so that's taking these retrospective payment accuracy audits I've talked about from a clinical perspective and moving them upstream. So, before a payer even cuts the check to provider, we're applying our advanced analytics slightly, we're identifying those claims, doing the audit and it not only brings a shortened revenue stream for us, because we get to recognize revenue at the time we adjust the claim, but it's much less provider abrasion.

The provider hasn't been paid yet. So, they're highly incented to send us the medical record. The findings are higher per average dollar amount and we have a lower provider abrasion rate and lower appeal rate. And that product now has been sold to five accounts across the spectrum of healthcare, Medicaid, Medicare Advantage and true commercial risk. And then we recently rolled out a Link Visualization product for fraud and that's really for a fraud analyst to be able look at data visually and say, I can make a connection to see that gastroenterologist did an endoscopy. The gastroenterologist in renal did an endoscopy on the entire family in LA. I can see that connection visually and I had to drill down into that, because there was probably something wrong there.

And part of fraud analytics is clients get tons of data and reports, but they don't get things that are actionable. So this allows them to drill down faster there. And on that one, we're looking for really a lighthouse account to help us complete the building of that product. I think what I've kind of touched on is that we are looking for other ways to use our data with appropriate data use rights and there's a number of ways to do that both helping our clients identify the risk of members that are coming into their plan, which they often take quite a bit of time to figure out until claims start to accumulate, but if we've seen that person before we know what their clinical history looks like through our claims data and the other is to aggregate data to find providers and look at their behavior across multiple plans, and when we do that, we see a significant amount of questionable providers or actual fraudulent providers.

I mentioned acquisitions; we do have a strong balance sheet, relatively low debt, we have solid quarterly cash flow and we're always making that build-buy analysis, it's really to generate or to accelerate our entry into a market. And part of it's really because our customers, even though we don't do some of these things today, they're coming to us and asking us to do them. So, in many ways if it's going to be easier for us to find an acquisition target and plug it in to this large and growing customer base.

Now we'll talk a little bit about our first quarter results. Our total first quarter revenue was 8.6% year-over-year higher, driven primarily by this nearly 30% increase year-over-year in our commercial health plan revenue. Our state government revenue declined, but we expected that and that was really due to somewhat of an unfavorable comparison. Our first quarter last year in 2015, we had this huge spillover effect of all that increased Medicaid enrollment that happen in 2014 from the ACA, and that made our numbers much higher in the first quarter of 2015.

We don't really see that spillover effect this year so the comparisons would show a drop in state government revenue, but we're planning for a flat to 2% growth in state government this year. And as I mentioned before, two out of every three new Medicaid members are in Medicaid managed care plans. So they show up in our commercial health plan business, not in our state Medicaid business.

Our Medicare RAC revenue was $9 million for the quarter. That revenue was really generated from audits that started prior to this new medical record request limits that went into place in January. So, it was really all of the audits that we started and kicked off in the fourth quarter of 2015.

I think what's important is year-over-year our payment integrity line of business, which is our newer line of business growth exceeded 15%. So, that's very encouraging and that's just again the appetite for our health plans to buy things other than our coordination of benefits business and for the problems that they're seeing financially.

So, let's kind of sum it up in terms of our competitive strengths. We really think we've got a great position in a very attractive growing market. We have this enormous database of eligibility and paid claims, from which we do very sophisticated analytics. We have depth of program expertise across the healthcare industry, but significantly in Medicaid, which is a problematic and growing part of the US healthcare system.

We have this HITRUST certification, it's a gold standard. We spent a lot of money to get there and we maintain it. So, from a security perspective, our clients care about that. We have a credentialled staff of clinicians, coders, nurses and doctors, that work on behalf of our clients and that's very important to them. And then this very large customer base, 250 health plans, 45 states and the District of Columbia and the federal government to whom we can sell additional products. And I think most important is this high ROI of 10 to 15:1, where we've demonstrated to deliver excellent results to our customers.

So, I'll quickly go over just some of our key themes for 2016. Ink to green, getting the business that we sold revenue generating; innovating with product development, to stay ahead of the competition, but to create or to build for the demand that our clients are asking for; reducing our expenses by reducing the unit cost of everything we deliver and boosting the yield; and of course maximizing this large growth in our health plan business, which has now overtaken our state government business.

And I think in many ways this slide really summarizes why HMS and why now. As you know, according to CMS, healthcare expenditures are expected to grow more than 75% in the current decade alone. We have an extraordinary opportunity to help our customers bend this cost curve. In fact, we're one of the few services out there that has bent the cost curve, and so our customers continue to rely on us to do that with our proven tools and the new tools we're developing.

I want to thank you for attending our presentation today and I look forward to the Q&A session.