Fiscal Year 2024 Second Quarter Earnings

Tuesday, February 6, 2024

Corporate Participants

Ryan Kubota, Director, Investor Relations
Patrick Blair, President, and Chief Executive Officer
Ben Adams, Chief Financial Officer

Ryan Kubota, Director, Investor Relations

Thank you operator.

Good afternoon, and thank you all for joining the InnovAge fiscal 2024 second quarter earnings call. With me today is Patrick Blair, President and CEO, and Ben Adams, CFO. Doctor Rich Feifer, Chief Medical Officer, will also be joining the Q&A portion of the call.

Today, after the market closed, we issued an earnings press release containing detailed information on our quarterly results for our fiscal second quarter 2024. You may access the release on the Investor Relations section of our company website, InnovAge.com.

For those listening to the rebroadcast of this call, we remind you that the remarks made herein are as of today, Tuesday, February 6th, 2024, and have not been updated subsequent to this call. During our call we will refer to certain non-GAAP measures. A reconciliation of these measures to the most directly comparable GAAP measures, can be found in our earnings press release posted on our website.

We will also be making forward-looking statements, including statements related to our full fiscal year projections, future growth prospects, Florida de novo centers, our acquisition of ConcertoCare, our payer capabilities and clinical value initiatives, the status of current and future regulatory actions, and other expectations.

Listeners are cautioned that all of our forward-looking statements involve certain assumptions and are inherently subject to risks and uncertainties that can cause our actual results to differ materially from our current expectations. We advise listeners to review the risk factors discussed in our Form 10-K annual report for fiscal year 2023 and our subsequent reports filed with the SEC, including our most recent Quarterly Report on Form 10-Q.

After the completion of our prepared remarks, we will open the call for questions. I will now turn the call over to our President and CEO, Patrick Blair. Patrick?

Patrick Blair, President and Chief Executive Officer

Thank you, Ryan, and good afternoon, everyone. I want to begin by expressing my continued appreciation to our colleagues, participants, government partners, and the investor community who support InnovAge.

The company's second quarter results were consistent with our expectations and highlight the ongoing performance improvement across the business. It further demonstrates incremental progress in our broader transformation plan to accelerate responsible growth while restoring operating margin lost during the regulatory sanction period.

We reported revenue of $189 million dollars for the quarter, an increase of approximately 3.5 percent compared to the first quarter, and center level contribution of $34 million dollars, which represents a 17.8 percent margin. Adjusted EBITDA was $7.8 million dollars for the quarter, which represents a significant improvement compared to the first quarter, which was approximately $2.2 million dollars. Census increased to 6,780, which represents a quarter over quarter improvement of 3.0 percent.

A few highlights:

- Participant net enrollment growth for the quarter was solid at 195 which continues to strengthen our confidence in the value proposition we are delivering.
- Our clinical value initiatives, CVIs as we refer to them, which focus on unnecessary utilization and lowering medical cost trends, are maturing in line with our expectations and beginning to translate into enhanced quality and greater operational efficiency as evidenced by a quarter over quarter decrease in our participant expense PMPM of 0.7%. We are still in the early innings of this work but are pleased with the progress we are making.
- We are managing our non-center costs effectively in our enterprise service functions resulting in a sequential decrease in general and administrative expenses as a percentage of revenue from 15.9% to 13.4%; and
- We completed the implementation of the new Epic EMR in all locations.
- On December 1st, we acquired ConcertoCare PACE, which added two new centers in the highly strategic Southern California market.
- On January 1st, we officially opened our new center in Tampa and are now operational in six states – Colorado, California, Pennsylvania, New Mexico, Virginia, and Florida.

With half our fiscal year behind us, we are pleased with our progress and remain laser focused on exiting Fiscal 2024 with solid earnings momentum. While we have demonstrated strong sequential quarter over quarter progress, significant work remains to achieve our financial goals for the second half of Fiscal 2024, and to create a glide path for a successful Fiscal 2025. As I mentioned last quarter, we have a great team, confidence in our plan, and it continues to come

down to consistent execution. We remain focused on the levers that drive near-term performance, while continuing to build a long-term foundation of compliance and operational excellence. Simply put, we believe we are on-track to unlocking the full potential of the organization at an intentional pace, which will take perseverance and time.

Before turning to our quarterly performance, I want to take a moment to address the California regulatory update included in our 10-Q. As you'll recall, we were released from enrollment sanctions in our Sacramento center by CMS in November of 2022 and by the California Department of Healthcare Services (DHCS) in May 2023. Underpinning that release was validation from both agencies that corrective actions had been resolved to their satisfaction and that there were no remaining systemic concerns.

In October 2023, CMS and DHCS conducted the final annual routine audit of our Sacramento center, as required for all new PACE centers during their first three years of operations. Following that audit, CMS approved our corrective actions in accordance with their findings. DHCS notified us two weeks ago that it had identified deficiencies. Last week, they shared the specific findings with us. After careful review of the findings, which are similar to the CMS findings, which we are in the process of remediating, we are confident that we have in place the policies, processes, and systems to correct the identified issues. DHCS also communicated that it will be conducting a targeted medical review of our San Bernardino center. DHCS has suspended its state attestations in support of our planned de novo centers in Downey and Bakersfield, which were scheduled to open this summer but has indicated it will evaluate lifting the suspension upon resolution of the matter. We remain confident that we will successfully address any issues to the full satisfaction of DHCS, and upon satisfactory remediation, that DHCS will reinstate the attestations. We also remain confident with regard to our expansion plans.

This is a highly regulated area. Rightfully so. Audits and corrective actions are normal course for all PACE organizations given the populations we serve. We have seen the benefits of the foundational changes we've made in every center over the last two years to provide high quality care. We work closely with our regulators on their audits and conduct our own audits in each center, every month – and we have consistently seen a clear, positive trendline. When opportunities for improvement at one center are identified, we make them quickly and then cascade learnings across the organization.

I want to be clear: compliance has been my north star since I joined this company two years ago and that will always be the case. Our leaders share my commitment to transparency – and embrace the opportunity to collaborate with our state and federal regulators to continuously improve our business. I felt it was important to share this context – and draw the critical distinction of where we are today, relative to two and half years ago.

Now, I will turn to details about our recent performance, starting with:

Existing-center growth:

New participant monthly enrollment continues above pre-sanction levels for the second consecutive quarter, consistent with our expectations. As I mentioned at the outset, we enrolled 195 participants in the quarter and have enrolled more than 375 participants in the first half of the fiscal year. As we approach the third fiscal quarter, we anticipate some modest seasonality related to the Medicare annual enrollment period. This organic growth contributes to two key objectives: efficiently utilizing excess capacity in our centers, and new growth, especially in Colorado, helps rebalance the overall mix of our participant risk pool. We're pleased to see that our new participants reflect an appropriate balance of individuals living independently in the community and those that may require some level of supportive housing.

We continue to see strong demand for our integrated solutions that allow seniors to stay in their homes and communities and out of nursing homes. This demand is most evident in the sequential increase in total sales qualified leads which is up approximately 11% from the prior quarter. Last quarter, we touched on enrollment as a joint effort between InnovAge and our state partners. While we are seeing aggregate enrollment consistent with our expectations, we continue to observe challenges in select markets which have resulted in enrollment processing delays, in part due to Medicaid redetermination. The barriers we are experiencing include state enrollment resource constraints, post-public health emergency policy changes that now require in-person level of care assessments vs telephonic, and new state vendors who are still ramping up to targeted service levels. Recall that this does not affect the eligibility of potential participants but rather the speed through which we can get them enrolled into PACE. However, lengthy delays can result in prospects evaluating other options and can translate into missed enrollment opportunities. Our state partners remain active and committed to resolving these issues with us as rapidly as possible. To state the positive, we are finding more eligible participants interested in joining InnovAge than we are currently enrolling today.

On the de novo front, we're pleased to announce that we are operational at our new Tampa center. Recall, this state-of-the-art center is approximately 42 thousand square feet and is expected to serve approximately 1,300 participants at maturity. Enrollment efforts are underway and job number one is to begin expanding access to the many deserving eligible participants in the community. We believe Florida is an attractive sixth state given the number of eligible individuals and the lack of integrated solutions for the frail dual eligible population.

We're also in the final push of pre-launch activities for our Orlando center. Like Tampa, it is comparably sized and represents our latest "best practices" in terms of building design, technology-enablement, and operating model. We anticipate Orlando center will be ready to accept new participants in the fourth quarter, barring any unforeseen delays.

On December 1st, we completed the acquisition of two PACE centers in southern California from ConcertoCare. We consider this transaction more of a hybrid between an acquisition and a de novo as it included a recently opened center in the Crenshaw neighborhood of Los Angeles with minimal census and a center in the final stages of the application for licensure in Bakersfield. We have been evaluating several alternatives to continue responsible growth in this market – and these centers facilitate a faster and more cost-effective expansion compared to building the centers from scratch while enabling us to implement our operating model from day one. Of note, we anticipate these centers will add modest operating losses to our fully consolidated EBITDA near-term as we work through the maturity curve.

Taken together, we believe these new centers, along with our pending de novo center in Downey, demonstrate our ability to augment existing-center growth with cost-effective expansions. We are excited for the opportunity to serve more seniors in more geographies over the next several months while also increasing our overall portfolio capacity by approximately 30% once all of these centers are open, which we believe will be a meaningful driver of growth in the near-term and represent significant uplift in embedded earnings long-term.

You'll recall that we measure and drive accountability for results through our five-pillar performance framework, which includes people, service, quality, growth, and financial KPIs. We measure these in every center, every month. We continue to see strong results across our people, service, and quality pillars and will continue to invest in the people and resources necessary to further strengthen quality and compliance in each of our centers.

Separately, we continue to see improvements in reducing external provider costs as our portfolio of clinical value initiatives mature. In the aggregate, we are trending ahead of internal targets on most initiatives fiscal year to date, with strong progress in areas such as inpatient admissions and skilled short stay utilization. We've also observed meaningful improvement this quarter in areas such as reduced end of life costs and contract transportation costs.

One new area of focus in the last quarter is ensuring we have the highest performing supportive housing network from a quality, compliance, and cost perspective. We are continually learning and improving as we go through compliance and quality audits. One of our key learnings is how dependent our quality, compliance and financial performance is on the quality of nursing facilities and assisted living facilities in our network--given we have ultimate accountability for the care that is provided and administered in these settings. With this in mind, we have increased our focus on the quality and value of our supportive housing network. By ranking our providers on the dimensions of quality of care, compliance, cost, and cooperation, and by narrowing our network around higher performing facilities, we're able to ensure our participants have access to the highest performing providers in their community.

We are seeing similar progress in the management of our general and administrative expenses. This quarter, we saw a sequential decrease in G&A of approximately $3.6 million dollars. Importantly, ongoing growth will help to right size our overall cost structure as we continue to expand revenue through existing center enrollment and new center development.

Lastly, we are pleased to report that we are now operational across our entire portfolio with the first ever pace-specific instance of Epic. As we have discussed previously, this was a significant investment in dollars and time for the organization, and we view our new EMR as a chief enabler of increased operational productivity, efficiency, compliance, and clinical staff satisfaction going forward. While it will take some time to achieve full adoption and the expected benefits in our newer markets, we're already seeing early wins in terms of operational and clinical efficiencies.

In summary, we believe we are improving the business every quarter and I again want to thank the 2,100 InnovAge colleagues nationally who are working tirelessly to make this wonderful program a reality for our participants every single day. We remain focused on the actions that are unlocking both near-term and long-term value and believe it will translate into both enhanced competitive differentiation in the marketplace, as well as improved financial performance.

Finally, I want to remind the audience that we are excited to be hosting our first investor day on February 27th in New York where we will provide more details on the journey we are on.

And with that, I'll turn it over to Ben to walk through our quarterly financial performance.

Ben Adams, Chief Financial Officer

Thank you Patrick.

Today, I will provide some highlights from our second quarter fiscal year 2024 financial performance, a reaffirmation of our fiscal 2024 guidance, and some insight into some of the trends we are seeing heading into the spring. While it is still early in our margin improvement initiatives, we continue to track to our internal targets and are pleased with the progress we have made so far this fiscal year.

Starting with census, we ended the second quarter of fiscal year 2024 with 18 centers and approximately 6,780 participants as of December 31, 2023. We also reported 20,130 member months in the second quarter, a 3 percent increase to both ending census and member months compared to the first quarter.

Total revenue increased by 3.5 percent to $188.9 million dollars in the second quarter compared to the first quarter due primarily to an increase in member months coupled with an increase in capitation rates, primarily due to a one-time Medicare true up outside the regular payment cycle recorded in the second quarter.

We incurred $101 million dollars of external provider costs during the second quarter of fiscal 2024, a 1.6 percent increase compared to the first quarter. The sequential increase was driven by an increase in members months, partially offset by a decrease in cost per participant. The cost per participant decrease was driven by lower permanent nursing facility utilization, partially offset by an increase in inpatient utilization, which it not uncommon in the winter months.

Cost of care, excluding depreciation and amortization, of $54.3 million dollars decreased 1.7 percent compared to the first quarter. The decrease was due to lower cost per participant, partially offset by the increase in member months.

The cost per participant decrease was driven by:

- A reduction in fleet expense including contract transportation, fuel costs, and vehicle repairs and maintenance, as well as a reduction in supplies expense.
- This was partially offset by an increase in FTEs and annual wage rate increases.

Center-level contribution margin, which we define as total revenue less external provider costs and cost of care, excluding depreciation and amortization, was $33.6 million dollars for the quarter compared to $27.9 million dollars in the first quarter. As a percentage of revenue, center-level contribution margin increased to 17.8 percent, compared to 15.3 percent in the first quarter reflecting an improvement in the quality of our earnings in our centers.

Sales and marketing expense was $5.9 million dollars, an increase of approximately $500 thousand dollars compared to the prior quarter. The increase was primarily due to increased marketing spend as we launched our new marketing campaign in November and increased headcount.

Corporate, general and administrative expense declined to $25.2 million dollars; a $3.7 million dollar decrease compared to the first quarter.

The decrease was primarily due to:

- A reduction in third party costs related to legal, consulting and financial reporting, and
- Decreased implementation costs associated with Epic.

The decrease was partially offset by an increase in IT license fees, inclusive of Epic, and bad debt.

Net loss was $3.8 million dollars compared to net loss of $11 million dollars in the first quarter. We reported a net loss per share of 3 cents, on both a basic and diluted basis and our weighted average share count was approximately 135.9 million shares for the quarter, on both a basic and fully diluted basis.

Adjusted EBITDA, which we calculate by adding interest expense, taxes, depreciation and amortization, M&A and de novo center development expenses, and other non-recurring or exceptional costs to net loss, was $7.8 million dollars for the quarter, compared to $2.2 million dollars in the first quarter.

Our Adjusted EBITDA margin was 4.1 percent for the second quarter, compared to 1.2 percent in the first quarter.

De novo losses, for the second quarter were $2.2 million and related to our acquisition of ConcertoCare, which occurred on December 1st, and our centers in Florida. This compares to $1.6 million dollars of de novo loses in the first quarter.

Turning to our balance sheet, we ended the quarter with $54.1 million dollars in cash and cash equivalents plus $44.7 million dollars in short-term investments. We had $83.7 million dollars in total debt on the balance sheet (representing debt under our senior secured term loan plus finance lease obligations and other commitments). For the second quarter, we recorded negative cash flow from operations of $9.3 million dollars, and we had $1.6 million dollars of capital expenditures, excluding the purchase price of ConcertoCare.

We are re-affirming our fiscal 2024 guidance which now includes the ConcertoCare acquisition.

Based on the information as of today:

- We expect our ending census for fiscal year 2024 to be between 6,800 and 7,400 participants, and member months to be in the range of 79,000 to 83,000.
- We are projecting total revenue in the range of $725 million dollars to $775 million dollars, and adjusted EBITDA in the range of $12 million dollars to $18 million dollars.
- Finally, we anticipate that de novo losses for fiscal 2024 will be in the $10 to $12 million-dollar range, which again is inclusive of our recent acquisition of ConcertoCare.

In closing, I want to reiterate Patrick's comments as we believe we are continuing to make improvements to the business every quarter. We remain focused on all aspects of the business to drive near-term and longer-term value and we look forward to providing more details at our upcoming investor day on the 27th of February. We will provide details on the event later this week.

Operator, that concludes our prepared remarks, please open the call for questions.

Forward-Looking Statements – Safe Harbor

This press release may contain "forward-looking statements" within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as: "anticipate," "intend," "plan," "believe," "project," "estimate," "expect," "may," "should," "will" and other words and terms of similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events. Forward-looking statements may be identified by the fact that they do not relate strictly to historical or current facts. Examples of forward-looking statements include, among others, statements we may make regarding quarterly or annual guidance; financial outlook, including future revenues and future earnings; our expectations to increase the number of participants we serve, to grow enrollment and capacity within existing centers, to build and/or open de novo centers, or to find targets and execute tuck-in acquisitions; our ability to control costs, mitigate the effects of elevated expenses, expand our payer capabilities, implement clinical value initiatives and strengthen enterprise functions; the potential effects of the macro-economic environment and lingering COVID-19 impacts on our business; our expectations with respect to current audit post-sanction work, legal proceedings and government investigations and actions; relationships and discussions with regulatory agencies; our ability to effectively implement remediation measures, including creating operational excellence as a provider across all our centers; reimbursement and regulatory developments; market developments; new services; integration activities; industry and market opportunity; and the effects of any of the foregoing on our future results of operations or financial conditions.

Forward-looking statements are neither historical facts nor assurances of future performance. Instead, they are based only on currently available information and our current beliefs, expectations and assumptions regarding the future of our business, future plans and strategies, projections, anticipated events and trends, the economy and other future conditions. You should not place undue reliance on our forward-looking statements. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict and many of which are outside of our control. Our actual results and financial condition may differ materially from those indicated in the forward-looking statements. Important factors that could cause our actual results and financial condition to differ materially from those indicated in the forward-looking statements include, among others, the following: (i) the viability of our growth strategy; (ii) our ability to identify and successfully complete and integrate acquisitions; (iii) our ability to attract new participants and retain existing participants and grow our revenue throughout our existing centers; (iv) the results of periodic inspections, reviews, audits, and investigations under the federal and state government programs, and our ability to sufficiently cure any new and recurring deficiencies identified by the respective federal and state government programs; (v) the adverse impact of inspections, reviews, audits, investigations, legal proceedings, enforcement actions and litigation, including the current civil investigative demands initiated by federal and state agencies, as well as the litigation and other proceedings initiated by, or on behalf, of our stockholders; (vi) the risk that

the cost of providing services will exceed our compensation under the Program of All Inclusive Care for the Elderly ("PACE"); (vii) our increased costs and expenditures in the future and our inability to execute or realize the benefits of our clinical value initiatives; (viii) the impact on our business from ongoing macroeconomic challenges, including labor shortages and inflation; (ix) the dependence of our revenues and operations upon a limited number of government payors; (x) the risk that our submissions to government payors may contain inaccurate or unsupportable information, including regarding risk adjustment scores of participants; (xi) the impact on our business of renegotiation, non-renewal or termination of capitation agreements with government payors; (xii) the difficulty to predict our future results, which could cause such results to fall below any guidance we provide; (xiii) the impact of state and federal efforts to reduce healthcare spending; (xiv) the effects of a pandemic, epidemic or outbreak of an infectious disease, such as COVID-19; (xv) our dependence on our senior management team and other key employees; (xvi) the impact of failures by our suppliers or limitations on our ability to access new technology or medical products; (xvii) the concentration of our presence in Colorado; (xviii) our ability to manage our operations effectively, execute our business plan, maintain effective levels of service and participant satisfaction and adequately address competitive challenges; (xix) our ability to compete in the healthcare industry; (xx) our ability to establish a presence in new geographic markets; (xxi) the impact of competition for physicians and other clinical personnel and related increases in our labor costs; (xxii) labor relations matters, including unionization efforts; (xxiii) the impact on our business of security breaches, loss of data or other disruptions causing the compromise of sensitive information or preventing us from accessing critical information; (xxiv) our ability to effectively invest in, implement improvements to and properly maintain the uninterrupted operation and data integrity of our information technology and other business systems; (xxv) our ability to accurately estimate incurred but not reported medical expense or the risk scores of our participants; (xxvi) risks associated with our use of "open-source" software; (xxvii) the impact on our business of the termination of our leases, increases in rent or inability to renew or extend leases; (xxviii) the impact of weather and other factors beyond our control; (xxix) the effect of our relatively limited operating history as a for-profit company on investors' ability to evaluate our current business and future prospects; (xxx) our ability to adhere to complex and changing government laws and regulations in the healthcare industry, including U.S. Healthcare reform, the regulation of the corporate practice of medicine and the Health Information Technology for Economic and Clinical Health Act of 2009 (the "HITECH Act"), and their implementing regulations (collectively, "HIPAA"), the California Consumer Privacy Act ("CCPA") and other privacy laws and regulations in the healthcare industry; (xxxi) our status as a "controlled company"; (xxxii) our ability to maintain effective internal controls over financial reporting and other enhanced requirements of being a public company; (xxxiii) our ability to maintain and enhance our reputation and brand recognition; (xxxiv) the impact on our business of disruptions in our disaster recovery systems or business continuity planning; (xxxv) impact of negative publicity regarding the managed healthcare industry; and (xxxvi) other factors disclosed in the section entitled "Risk Factors" in our Annual Report for the year ended June 30, 2023 filed

with the Securities and Exchange Commission (the "SEC") on September 12, 2023, and our subsequent filings with the SEC.

Any forward-looking statement made by the Company in this press release is based only on information currently available to us and speaks only as of the date on which it is made. Except as required by law, we undertake no obligation to publicly update any forward-looking statement, whether written or oral, that may be made from time to time, whether as a result of new information, future developments or otherwise.