Fiscal Year 2024 First Quarter Earnings

Tuesday, November 7, 2023

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 first 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 close, we issued a press release containing detailed information on our quarterly. You may access the release on 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, November 7th, 2023, 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 fiscal first quarter 2024 earnings release, which is posted on the Investor Relations section of our website.

We will also be making forward-looking statements, including statements related to our future growth prospects, Florida de novo centers, potential acquisitions, 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 Quarterly Report on Form 10-Q for our fiscal first quarter 2024.

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 ongoing gratitude to our InnovAge colleagues, participants, government partners, and the investor community who support the organization.

As it's only been two months since we reported fiscal year 2023 results on September 12th, my remarks will be brief and hit on our results for the first quarter of fiscal year 2024 and progress in our key focus areas.

The company's first quarter results were in line with our expectations and reflect continued momentum in our People, Service, Quality, Growth, and Financial performance measures. Our progress in these areas gives us confidence that we're growing our business in a financially responsible way, delivering high-quality service to our participants, all while ensuring our employees are engaged and committed to our mission. I'll spend more time on these areas in a moment.

We reported revenue of $182.5 million dollars, an increase of approximately 3.2 percent compared to the fourth quarter of fiscal year 2023, and center level contribution of $27.9 million dollars, which represents a 15.3 percent margin. Adjusted EBITDA was $2.2 million dollars for the quarter, which represents a significant improvement compared to the fourth quarter of fiscal year 2023, which was approximately $700 thousand dollars. Census increased to 6,580, which represents a quarter over quarter improvement of 2.8 percent.

The results represent continued sequential improvement, and we remain convinced that we have the capacity to deliver even more value to our federal, state, and shareholder partners over time. We have the right team in place, and we continue to build and enhance our processes, and technology. It now boils down to driving consistent execution. That said, we are still in the early innings post-sanctions and on the path back to unlocking the full potential of the organization. We remain focused on growing into the slack capacity at our existing centers which is creating operating leverage and enabling contribution margin improvement through incremental enrollments until we reach target staffing ratios. Particularly in the Colorado market, enrollment growth is driving better center labor utilization, and this is also helping rebalance our mix of new and tenured participants, which should improve participant PMPM expense over time.

While we remain steadfast in our sense of sense of urgency, it will take time to achieve the full impact of our performance improvement initiatives. For example, while overall external provider costs were modestly higher than the fourth quarter of fiscal year 2023, we observed positive trends within the quarter which indicates that the clinical value initiatives we launched in earnest late last year are starting to impact our medical costs. As we noted in our last call, we expect improvement in our medical costs throughout the fiscal year as our initiatives mature and growth positively impacts our participant mix.

Turning back to our performance across People, Service, Quality, Growth, and Financial measures, we've just concluded our quarterly reporting for Employee Engagement (our People measure), Participant Net Promoter Score, or NPS (our Service measure), and Clinical Quality. Our Employee Engagement Score increased by 5% to 77%, reflecting increases in 12 of our centers. Our Participant NPS increased by 13 points to 47, reflecting improvement in 15 of our centers. And, based on the NPS methodology, we believe our score positions us comparatively among the top tier of healthcare organizations. From a quality perspective, we're seeing solid results in inpatient utilization, fall rates, and cognitive screenings, among others, and we believe our results reflect top-tier performance among PACE organizations. It's our strong belief that when you have highly engaged employees delivering great service and quality, growth and financial performance will follow.

I'll now spend a few minutes walking through our key focus areas:

Starting with existing-center growth, new participant monthly gross enrollment is back to pre-sanction levels. We enrolled over 200 participants across all of our centers in both August and September, which is consistent with the company's best pre-sanction periods. Specifically, the enrollment ramp in our previously sanctioned markets continues to gain momentum as Sacramento is now at pre-sanction levels and Colorado has seen monthly sequential improvement over the last 6 months. Further, our East region gross enrollments are up 33% for the first quarter of fiscal year 2024 compared to the first quarter of fiscal year 2023. Contributing to our post-sanction enrollment ramp is the success of our new digital marketing initiatives. We've seen first quarter sales qualified leads increase by approximately 75 percent, year over year, which gives us increasing confidence that our marketing messages are reaching our target audiences and there is strong interest in our value proposition from underserved seniors looking for services and supports to help them stay safely in their homes as they age.

Given the increased digital lead volume, we've made a modest investment in an inside sales team that is working the digital leads—which allows our Field Enrollment teams to remain focused on self-generated leads from our community referral partners. While it's still early days for the inside sales capability, we're optimistic about the impact on growth, Field Enrollment productivity, and reducing participant acquisition costs.

You'll recall last quarter we touched on enrollment as a joint effort between InnovAge and our state partners—and the state's sub-contractors who may perform assessments, validate our assessments, and ultimately process the applications and activate new enrollments. We continue to observe situational delays in some markets in the processing of enrollment applications, and we primarily attribute this to state resource constraints. While this does not impact the eligibility

of our prospective participants, it can delay enrollments and cause eligible participants to seek other solutions. We are working collaboratively with all the stakeholders for which we have some dependency to address delays proactively as they surface to ensure we can enroll deserving seniors as quickly as possible. I would like to take a moment to thank our partners for their ongoing support and collaboration as we work together to help more seniors benefit from PACE.
New-center growth:

In Florida, we continue to make progress on the administrative requirements to open centers in Tampa and Orlando. We recently moved to the next stage of the process in Tampa which is the final review by CMS. In Orlando, we conducted the State Readiness Review in October and anticipate feedback imminently. You'll recall from last quarter's update that we are targeting opening around the end of the calendar year. While we are doing everything in our control to open these centers as quickly as we can, not all the steps are in our locus of control, and it is becoming increasingly likely that opening dates for Tampa and Orlando could shift to early in the new year. Overall, we remain enthusiastic that these two centers will expand our total center and census capacity by over 20 percent and believe each center, with census capacity of 1,300, will meaningfully increase our overall organic growth curve over the next couple of years.

Regarding our de novo center in Downey, California, a large market southeast of Los Angeles, we continue to work with the Department of Healthcare Services in California toward a mid-year calendar 2024 opening.

We are excited to get these new centers up and running and serving the communities. In addition to same-center organic growth, we believe these new locations create visibility into multi-year double digit topline growth and embedded future earnings.

Operationally, we continue to make meaningful progress improving how we are managing our centers according to what we call the One InnovAge way. We're reducing variation in business processes, policies, and procedures among our centers which is leading to improvements in operational compliance, productivity, clinical quality, and unit economics across our platform.

Clinically, we continue to strengthen our payer capabilities through our clinical value initiatives. This quarter, we have achieved meaningful improvements in inpatient utilization, which was 5.3 percent, relative to 5.8 percent in the fourth quarter of fiscal year 2023. We've kept our short stay skilled nursing utilization rate below 2.0 percent this quarter, which you'll recall was down approximately 23 percent in fiscal year 2023 relative to fiscal year 2022. And we've begun transitioning our assisted living facility and nursing home providers into high performing networks which include providers who consistently deliver more compliant and higher quality care, lower costs and are more collaborative with our care teams. We're excited about the impact this will have on the quality of care we can offer our participants. Further, we continue to work with our vendors to identify improvements in risk score capture accuracy.

Counterbalancing the improvements in utilization that we're seeing, we have observed some modest increase in inpatient unit costs and higher outpatient services utilization in the first quarter, which isn't unexpected as we continue to work through the lingering risk pool impacts of the Colorado sanction on participant acuity. We continue to work through the multiple levers to get to target levels and ensure a financially attractive margin overall.

Regarding technology, we have 14 of our 17 centers live on Epic, with the remainder scheduled for the second fiscal quarter. Though it takes time to realize the full extent of anticipated benefits from a new system, we're encouraged by the operational efficiencies that are emerging and the positive feedback our administrative and clinical teams are sharing. For example, since going live in Pennsylvania, Virginia, and Colorado, we have exchanged over two hundred thousand participant health records with specialists and hospital partners using Epic's interoperability capability within their provider ecosystem. Previously, this level of health information exchange consumed significant labor and time and was prone to inefficiency and re-work. Now, we have a single record source which is shared and available real-time with many of our external partners. We expect that in time, the network effect will grow, and it will enable better service, access, quality, costs, and labor efficiency.

Further, Epic ranks its users against the overall Epic community as our clinicians go live and features are implemented. As a testament to our early progress, Epic has shared with us that we're in the top quartile of feature adoption in the areas of physician productivity, nurse productivity, and population health management. As I've mentioned, these are all dials and not switches – but we're pleased to see these activities starting to have impact and ultimately value.

In summary, we are just beginning to unlock the full potential of the organization. I greatly appreciate the continued commitment from our more than 2,100 colleagues nationally, and the ongoing support of our valued government partners. We remain focused on demonstrating incremental improvement quarter over quarter in each of our focus areas. I believe there is momentum building from our team's work, and in time, this will translate to improved financial performance and enable us to return to normalized margins. We are humbled by the responsibility to serve the many underserved PACE eligibles in our communities and are thrilled to be returning to responsible growth.

With that, I'll turn it over to Ben to review the financials in detail.

Ben Adams, Chief Financial Officer

Thank you Patrick.

Today, I will provide some highlights from our first quarter fiscal year 2024 financial performance compared to the fourth quarter as well as provide insight into some of the trends we are seeing as we head into the winter months of the year. While it is still early in the fiscal year, we continue to track and make progress on the guidance targets we provided on our fourth quarter earnings call.

Starting with census, we ended the first quarter of fiscal year 2024 with 17 centers and approximately 6,580 participants as of September 30, 2023. This represents an ending census increase of 2.8 percent compared to last quarter.

We reported approximately 19,540 member months in the first quarter of fiscal year 2024, a 2.3 percent increase compared to the fourth quarter.

Total revenue increased by 3.2 percent to $182.5 million dollars in the first quarter compared to the fourth quarter primarily due to an increase in member months coupled with an increase in capitation rates associated with annual Medicaid rate increases effective July first, and partially offset by favorable Medicare risk score true ups recorded in the fourth quarter.

We incurred $99.4 million dollars of external provider costs during the first quarter of fiscal 2024, a 4.6 percent increase compared to the fourth quarter. The sequential increase was driven by an increase in members months, as we continue to grow census, coupled with an increase in cost per participant. The cost per participant increase was driven by higher assisted living and nursing facility unit cost as a result of annual provider increases, higher cost per admission due to acuity, and an increase in pharmacy expense. These costs were partially offset by reductions in permanent and short stay nursing facility utilization, and a reduction in inpatient utilization.

Cost of care, excluding depreciation and amortization, of $55.3 million dollars was 3.5 percent higher compared to the fourth quarter. Primary cost drivers include salaries, wages and benefits, primarily associated with annual merit increases, and an increase in fleet and contract transportation utilization as a result of census growth, higher fuel costs, vehicle repairs and maintenance. These costs were partially offset by a reduction in third party audit remediation and consulting costs.

Center-level contribution margin, which we define as total revenue less external provider costs and cost of care, excluding depreciation and amortization, was $27.9 million dollars for the quarter compared to $28.5 million dollars in the fourth quarter. As a percentage of revenue, center-level contribution margin was 15.3 percent, compared to 16.1 percent in the fourth quarter.

Sales and marketing expense was $5.4 million dollars, a $750 thousand dollar decrease compared to the prior quarter. The decrease was mainly due to lower marketing spend as we focused on our digital channels in the first quarter ahead of a new marketing campaign that we launched this month.

Corporate, general and administrative expense declined slightly to $28.9 million dollars; a $50 thousand dollar decrease compared to the fourth quarter.

Net loss was $11 million dollars compared to net loss of $12 million dollars in the fourth quarter. We reported a net loss per share of 8 cents, on both a basic and diluted basis and our weighted average share count was approximately 135.8 million shares for the quarter, on both a basic and fully diluted basis.

Adjusted EBITDA, which we calculate by adding interest, taxes, depreciation and amortization, de novo losses, and other non-recurring or exceptional costs to net loss, was $2.2 million dollars for the quarter, compared to $700 thousand dollars in the fourth quarter. Our Adjusted EBITDA margin was 1.2 percent for the fiscal year, compared to 0.4 percent in the fourth quarter.

Adjusted EBTIDA of $2.2 million dollars is inclusive of de novo losses, which was $1.6 million for the first quarter and primarily related to our centers in Florida. This compares to $1.5 million dollars of de novo loses in the fourth quarter.

Turning to our balance sheet, we ended the quarter with $88.4 million dollars in cash and cash equivalents plus $46.8 million dollars in short-term investments. We had $85.5 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 first quarter, we recorded negative cash flow from operations of $33.6 million dollars, inclusive of approximately $15 million dollars in delayed payments from California that we received in October, and we had $2.6 million dollars of capital expenditures.

Finally, I will briefly touch on some of the trends that are developing as we head into the winter months.

Regarding census, our census growth is tracking in line with our guidance expectations. As Patrick mentioned, we continue to expect that states will have short term constraints around their ability to process new enrollments as they prioritize their needs to process Medicaid redeterminations along with their other obligations; however, we are not seeing that impact our census in a meaningful way.

Regarding revenue and rates, we have yet to finalize Medicaid rates in New Mexico and remain in active discussions with the state for fiscal year 2024. In California, we have started the annual rate process with the state, and we expect to know more about the state's timing in the coming weeks.

Regarding cost trends, as we head into the winter months, it is important to remember that we typically see an increase in external provider costs as a result of seasonality. Specifically, we expect to see higher inpatient and short stay nursing home utilization as well as increased acuity of our participant mix.

In closing, we continue to focus on improving the margin profile of the business by concentrating on the key drivers we highlighted last quarter:

- Accelerating census growth, which also serves to rebalance the participant risk pool as well as to unlock staffing capacity,
- Ensuring our participant risk scores are commensurate with our risk pool through improved participant data management as we fully implement EPIC,
- Optimizing revenue per participant through proactive actuarial discussions with our state Medicaid agencies, and
- Executing on clinical value initiatives to improve participant care and reduce unnecessary costs.

We hope to share more information on these key initiatives on our next call.

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 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, investigations under the federal and state government programs, including our ability to sufficiently cure 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 PACE; (vii) our increased costs and expenditures and our inability to execute or realize the benefits of our clinical value initiatives; (viii) the impact on our business from ongoing macroeconomic and COVID-19-related challenges, including labor shortages and inflation; (ix) the dependence of our revenues upon a limited number of government payors; (x) the risk that our submissions to government payors may contain inaccurate or unsupportable information 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) 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; (xxiii) 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; (xxiv) our ability to accurately estimate incurred but not reported medical expense or the risk scores of our participants; (xxv) risks associated with our use of "open-source" software; (xxvi) the impact on our business of the termination of our leases, increases in rent or inability to renew or extend leases; (xxvii) the impact of weather and other factors beyond our control; (xxviii) the effect of our relatively limited operating history as a for-profit company on investors' ability to evaluate our current business and future prospects; (xxiv) 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; (xxv) our status as a "controlled company"; (xxvi) our ability to maintain effective internal controls over financial reporting and other enhanced requirements of being a public company; (xxvii) our ability to maintain and enhance our reputation and brand recognition; (xxviii) the impact on our business of disruptions in our disaster recovery systems or business continuity planning; (xxix) impact of negative publicity regarding the managed healthcare industry; and (xxx) changes in accounting principles and guidance, resulting in unfavorable accounting charges or effects; and 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.