Fourth Quarter and Fiscal Year Ended June 30, 2024 Earning Call

Tuesday, September 10, 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 2024 fiscal fourth quarter and fiscal year end earnings call. With me today is Patrick Blair, President and CEO, and Ben Adams, CFO. Today, after the market closed, we issued an earnings press release containing detailed information on our fourth quarter and annual results. 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, September 10th, 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 2025 year projections, future growth prospects and growth strategy, our clinical and operational value initiatives, Medicare rates increases, census headwinds, 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 Annual Report on Form 10-K for fiscal year 2024 and any subsequent reports filed with the SEC.

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.

Today, we will provide several updates on:

- Our financial results for the fourth quarter and full year Fiscal 2024,
- Initial guidance for Fiscal Year 2025, and
- Progress in our key focus areas.

Let me start with our fourth quarter performance. Today, we reported revenue of approximately $199 million dollars, a sequential improvement of approximately 3.3 percent compared to the third quarter. Center level contribution margin was $36.6 million dollars, which represents an 18.3 percent margin. As Ben will cover in more detail, we have revised our definition of adjusted EBITDA this year resulting in fourth quarter adjusted EBITDA of approximately $5.2 million dollars, which represents a 2.6 percent margin. We finished the year with a census of approximately 7,020, just shy of the company's high-water mark of 7,074 in mid Fiscal 2022. Our fourth quarter completes a solid year of operating and financial performance.

Moving to full year performance, we reported total revenue of approximately $764 million dollars, an increase of approximately 11 percent compared to Fiscal Year 2023. Center level contribution was approximately $132 million, which represents a 17.3 percent margin. Year over year, center level contribution margin increased by approximately 260 basis points, from 14.7 percent to 17.3 percent, driven by census growth, disciplined medical cost management, and administrative cost controls. Consolidated adjusted EBITDA was $16.5 million dollars under our revised presentation, which represents a 2.2 percent margin, compared to negative $3.4 million dollars in Fiscal 2023, an improvement of approximately $20 million dollars. Under the previous presentation, our Fiscal 2024 EBITDA would have been $19.8 million, which compares favorably to our full year guidance of $12 to $18 million dollars.

We are proud of the strong year over year financial results – and the positive momentum - as we move out of the rebuilding period of our transformation and into the next phase of responsible growth and margin recapture.

To recap a few Fiscal 2024 operating performance milestones:

- We exceeded our employee engagement, participant satisfaction, and quality targets
- We acquired two California centers
- We executed a joint venture with Orlando Health
- We opened two new state-of-the-art centers in Florida

- We further strengthened essential payer capabilities in areas such as Medicaid rate actuarial soundness, risk score accuracy, provider network optimization, and medical cost management
- We increased center utilization by 440 basis points in our established centers
- We completed the Epic EMR rollout in all 20 centers, and
- We sold a non-core senior living facility and reinvested in our core business.

We outlined an ambitious agenda last year and believe we delivered. I am proud of our team for their perseverance, while keeping high quality, compliant care as our top priority. We plan to do the same in Fiscal 2025. We feel confident that we have created a differentiated and powerful platform from which to grow responsibly and profitably in Fiscal 2025, and we believe we are on-track to achieve the full potential of the organization in the years to come.

Turning now to our Fiscal year 2025 guidance, we project a census range of 7,300 to 7,750, member months of 86,000 to 89,000, total revenue of $815 million to $865 million dollars, consolidated adjusted EBITDA of $24 to $31 million dollars, and de novo loses of $18 to $20 million dollars. We anticipate seeing improvement in our profitability as the year progresses and exiting the year with higher run rate earnings. Consistent with the targets we provided at our February investor day, we expect our adjusted EBITDA margins to reach 8 to 9 percent over the intermediate term. Ben will take you through a more detailed Fiscal 2025 guidance review in a few minutes.

Now on to existing center growth, we used Fiscal 2024 to test and learn. We launched a new telephonic inside sales team to handle the increased lead volume from our referral partners and digital marketing campaigns. We built new referral partnerships which have created greater awareness of the PACE program and extended our reach into the communities we serve. We also optimized our digital campaigns which increased the volume and yield of qualified leads. And we've invested in tools and technology to make our enrollment teams more effective and productive.

However, as we've mentioned on the last couple of quarterly calls, challenges persist with enrollment processing times in some states. Specifically, we have been experiencing state delays completing the Level of Care assessments required for enrollment in PACE. We continue working closely with our state partners to address these delays and are beginning to see improvement.
Despite this headwind, we anticipate healthy overall topline growth and remain encouraged by robust demand for the PACE model of care. While we remain confident that these challenges will be resolved, the exact timing is not clear, and the uncertainty is reflected in our guidance. Should these challenges abate more quickly than anticipated, we would expect modest upside to our census this year.

In our de novo centers, we continue to make progress despite a slower start than we anticipated. Our new centers in Florida are gaining traction as we build awareness of PACE and InnovAge. And in Orlando specifically, we have created a joint venture with Orlando Health consistent with our strategy to find new avenues for growth by establishing partnerships with leading health system brands in our communities. The partnership is in the early stages, but we're excited by the potential, and we are honored to be working with such an outstanding organization.

In our new Crenshaw center, we're beginning to see our enrollment trend up on a month over month basis and we are largely hitting the mark on our expectations.

It's important to note that the full year impact of these new centers will create additional year-over-year operating losses in Fiscal 2025 as we work through the maturity curve of each of these de novo centers.

On the regulatory front, our focus is on bringing our California audits to conclusion. The San Bernardino state audit commenced in March, and the exit interview is anticipated within the next two months. In Sacramento, we submitted our corrective plans actions to the state in March and are still awaiting final feedback. Recall in March, CMS officially closed its portion of the audit. Following resolution of the audits and corrective actions in San Bernardino and Sacramento, we expect to resume discussions with the state regarding the reinstatement of our Downey and Bakersfield expansion plans.

Operationally, we remain laser focused on delivering compliant, high-quality care, with strong medical management and operating discipline at every center. To that end, our Fiscal 2024 external provider costs PMPM increased by approximately 3 percent in an inflationary environment where core healthcare costs trends significantly exceeded this level. This provides confidence that our operational and clinical teams are focused on the right levers which drive high quality care while reducing unnecessary utilization.

While we implemented several new clinical value initiatives last year, we expect to see the full year impact this year and will accelerate actions to drive continuous improvement and new initiatives in Fiscal 2025. As we enter year two on the Epic system, we are beginning to experience the benefits in care coordination, documentation, compliance, and risk score accuracy.

Further, we have introduced Operational Value Initiatives, or OVIs, to complement our Clinical Value Initiatives. These initiatives are focused on identifying value creation opportunities at the center level and the corporate SG&A level to drive staff productivity, operating efficiency, and improved vendor unit economics from better leveraging people, process, and technology. The foundations for operational excellence are in place across the organization – now we must execute a little better, every day.

In closing, we continue to make tangible progress every quarter. We have more top and bottom-line work to do but we are very pleased with our fiscal year 2024 performance and are confident in our fiscal year 2025 guidance. We view Fiscal 2025 as an important year to achieving our long-term goals and you can expect the same execution focus that you've seen from this team for the last two years. Lastly, I want to extend my deepest gratitude to our more than 2,000 employees who embrace our mission every day and enable our participants to have more healthy days. With that, I will turn the call over to Ben. Ben?...

Ben Adams, Chief Financial Officer

Thank you Patrick.

Today, I will provide some highlights from our fourth quarter and fiscal year-end 2024 financial performance, followed by our fiscal year 2025 guidance. Starting off with fiscal 2024 highlights, I am pleased with our overall performance and our strong finish to the year. The business's total revenue improved each quarter during the past fiscal year, and as Patrick and I have reiterated, we believe we are on the path to normalized margins over the intermediate term.

Starting with census, we served approximately 7,020 participants across 20 centers as of June 30, 2024. This represents an increase of 9.6 percent from 2023 and a 2.8 percent increase compared to the third quarter of 2024. We reported 80,840 member months in fiscal 2024, a 4.5 percent increase compared to the prior year.

Total revenue increased by 11 percent to $763.9 million dollars for fiscal year 2024. The increase was primarily driven by:

- An increase in member months, primarily due to the release of sanction in our Sacramento, California center and at our Colorado centers; and
- An increase in both Medicaid and Medicare capitation rates.

Compared to the third quarter, total revenue increased by 3.3 percent to $199.4 million dollars in the fourth quarter, primarily due to an increase in member months coupled with retroactive Medicare risk adjustment payments recognized in the fourth quarter.

We incurred $403 million dollars of external provider costs during the fiscal year, a 7.6 percent increase compared to fiscal year 2023. The increase was primarily driven by an increase in member months, coupled with an increase in cost per participant. The cost per participant increase was primarily driven by higher assisted living utilization and unit cost, as well as an increase in costs associated with higher utilization of professional services. These costs were partially offset by a reduction in permanent nursing facility utilization.

For the fourth quarter of fiscal 2024, we incurred $102.7 million dollars of external provider costs, a 2.7 percent increase compared to the third quarter. The sequential increase was primarily driven by an increase in member months coupled with an increase in inpatient and assisted living facility unit cost.

Cost of care, excluding depreciation and amortization, was $228.8 million dollars for fiscal year 2024, a 7.8 percent increase compared to fiscal 2023. The increase was primarily due to an increase in cost per participant coupled with an increase in member months. The increase in cost per participant was driven by:

- An increase in salaries, wages and benefits associated with increased headcount to support growth and higher wage rates,
- An increase in contract provider expense in California to support growth,
- Increased fleet expense and contract transportation as a result of higher average daily attendance, an increase in external appointments, and higher fuel costs,
- Increased building maintenance and security,
- An increase in software license fees, and
- An increase in de novo occupancy and administrative costs inclusive of the Concerto acquisition in December 2023.

This was partially offset by a reduction in costs associated with third party audit and compliance support.

In the fourth quarter, cost of care increased 1.8 percent to $60.1 million dollars compared to the third quarter. The increase was primarily due to an increase in headcount and contract providers in California.

Center-level contribution margin, which we define as total revenue less external provider costs and cost of care, excluding depreciation and amortization, which includes all medical and pharmacy costs, was $132.1 million dollars for fiscal year 2024, a 30.4 percent increase compared to fiscal year 2023. As a percentage of revenue, our center-level contribution margin ratio increased approximately 260 basis points to 17.3 percent compared to 14.7 percent in the prior year.

For the fourth quarter, center-level contribution margin was $36.6 million dollars compared to $34 million dollars in the third quarter. As a percentage of revenue, center-level contribution margin increased approximately 70 basis points to 18.3 percent compared to 17.6 percent in the third quarter.

Sales and marketing expense was $25 million dollars for fiscal year 2024, an increase of $5.3 million dollars compared to fiscal year 2023. The increase was primarily driven by increased marketing spend and an increase in salaries, wages and benefits associated with increased headcount, both of which were associated with the release of sanctions at our Colorado and Sacramento, California centers, and the opening of our new Tampa and Orlando centers in Florida.

In the fourth quarter, sales and marketing expense was $6.5 million dollars, a decrease of approximately $600 thousand dollars compared to the prior quarter. The decrease was primarily due to lower marketing spend in the quarter as we continue to refine our digital strategy and focus on lead quality. This follows the increased marketing spend in the third quarter for our newly opened Tampa center and recently acquired Crenshaw center.

Corporate, general and administrative expense decreased to $111.3 million dollars; a $4.3 million dollar decrease compared to fiscal year 2023. The decrease was primarily due to reductions in third party legal expense, insurance expense, consulting costs associated with improving organizational capabilities, including our transition to Epic, a reduction in contract staffing and lower recruiting expense. The decrease was partially offset by costs associated with an increase in headcount, bad debt expense, and consulting costs including SOX compliance, internal audit support and public relations. Corporate, general and administrative expense increased to $29.6 million dollars in the fourth quarter; a $2 million dollar increase compared to the third quarter.

The increase was primarily due to an increase in third party legal expense, partially offset by a reduction in D&O insurance expense.

We reported a net loss of $23.2 million dollars in fiscal 2024 compared to a net loss of $43.6 million dollars in fiscal 2023. On a per share basis, we reported a net loss of 16 cents compared to 30 cents in fiscal 2023.

For the fourth quarter, we reported a net loss of $2.3 million dollars compared to net loss of $6.2 million dollars in the third quarter. We reported a net loss per share of 1 cent, on both a basic and diluted basis, and our weighted average share count was approximately 136 million shares for the quarter, on both a basic and fully diluted basis.

Effective for fiscal 2024, we revised our calculation of Adjusted EBITDA to reflect the impact of other investment income and to no longer exclude de novo center development costs. We believe this revised presentation more closely reflects our operating core performance as we return to growth. All numbers for prior periods have been recast to conform to this revised presentation.
Fiscal year 2024 adjusted EBITDA was $16.5 million dollars compared to an adjusted EBITDA loss of $3.4 million dollars in fiscal 2023, an approximately $20 million dollar improvement. Our Adjusted EBITDA margin was 2.2 percent for fiscal 2024, compared to an adjusted EBITDA margin loss of 0.5 percent in the prior fiscal year. We reported adjusted EBITDA of $5.2 million dollars for the fourth quarter, compared to $3 million dollars in the third quarter and our adjusted EBITDA margin was 2.6 percent for the fourth quarter, compared to 1.5 percent in the third quarter.

Under the previous presentation, our Fiscal 2024 EBITDA would have been $19.8 million, which compares favorably to our full year guidance of $12 to $18 million dollars.

De novo losses, which are not included in our Adjusted EBITDA calculation and which we define as net losses related to pre-opening and start-up ramp through the first 24 months of de novo operations, were $12 million dollars for fiscal 2024 and primarily related to our centers in Florida and the recently acquired Bakersfield and Crenshaw centers. This compares to $4 million dollars of de novo loses in fiscal 2023.

For the fourth quarter, de novo losses were $4.2 million dollars compared to $4.1 million dollars in the third quarter.

Turning to our balance sheet, we ended the quarter with $56.9 million dollars in cash and cash equivalents plus $45.8 million dollars in short-term investments. We had $83.3 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 fourth quarter, we recorded cash flow from operations of $1.9 million dollars, had $3.3 million dollars of capital expenditures, and repurchased approximately 45,000 shares of our common stock for an aggregate of approximately $225 thousand dollars under the Company's $5 million dollar share repurchase plan.

Regarding our fiscal 2025 guidance, which we included in today's press release, based on the information as of today:

- We expect our ending census for fiscal 2025 to be between 7,300 and 7,750 and member months to be in the range of 86,000 to 89,000.
- We are projecting total revenue in the range of $815 million dollars to $865 million dollars, and adjusted EBITDA in the range of $24 million dollars to $31 million dollars.
- Finally, we anticipate that de novo losses for fiscal 2025 will be in the $18 to $20 million dollar range.

I will also provide some additional color on a few of the components that comprise our guidance assumptions.

Starting with revenue. As a reminder, our Medicare rates are based on county-specific rates that are adjusted by CMS in January coupled with prospective risk score adjustments in January and July. For Medicaid, our rates are contractually determined based on costs for PACE or comparable populations in each state. Additionally, in fiscal year 2025, we are updating our reporting methodology by recording bad debt as a contra revenue item rather than an expense.

Our fiscal year 2025, guidance takes this updated reporting methodology into account, and we are expecting a combined mid-single digit rate increase comprised of the following:

- A low-single digit Medicare Part C increase,
- A mid-single digit Medicare Part D increase, and

For Medicaid, a mid-single digit rate increase, inclusive of an 8.8 percent increase in Colorado (which includes funding for assisted living and nursing facility unit cost increases effective July 1), 2.5 percent in Virginia, an estimated low single digit rate increase in California effective January 1, 2025 and an estimated mid-single digit rate increase in Pennsylvania effective January 1st. We do not anticipate a rate increase in New Mexico at this time.

Finally, some thoughts on cost of care, external provider costs and overall center-level margins.

We've made demonstrable progress in the business over the course of fiscal 2024. As we highlighted during our investor day back in February, we believe that in the intermediate term, we can achieve adjusted EBITDA margins in the high single digits. We continue to focus our efforts on maintaining high quality and compliance standards while working diligently to offset annual cost trends with ongoing clinical value initiatives and our new operational value initiatives that Patrick touched on in his remarks.

Our fiscal 2025 guidance factors in the strong foundation we've laid for ourselves in fiscal 2024, the initiatives we are implementing to offset annual cost trends, and the temporary census headwinds that Patrick highlighted driven by state processing delays, which we believe create a compelling and achievable margin growth story towards our target of high single digit adjusted EBITDA margins over the intermediate term. We continue to make significant investments in the business, including updating our financial systems to Oracle, while maintaining a disciplined approach to costs and being ever mindful of providing high quality service and compliance in each of our centers.

In closing, we believe we are continuing to make improvements to the business every quarter. We remain focused on day-to-day operational execution and continuing the earnings momentum we laid the groundwork for in fiscal 2024.

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," "estimate," "expect," "project," "plan," "intend," "believe," "may," "will," "should," "can have," "likely" 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; the viability of our growth strategy including our ability or expectations to increase the number of participants we serve, build and/or open de novo centers, or to identify and execute tuck-in acquisitions, joint ventures and strategic partnerships; our ability to control costs, mitigate the effects of elevated expenses, expand our payer capabilities, implement clinical value initiatives and strengthen enterprise functions; the ongoing effects of the macro-economic environment; our expectations with respect to audits, post-sanction work, legal proceedings and government investigations and actions; relationships and discussions with regulatory agencies; our ability to effectively implement 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. 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 and may cause our actual results and financial condition to differ materially. Important factors that could cause our actual results and financial condition to differ materially include, among others, the following: (i) the viability of our growth strategy; (ii) our ability to identify and successfully complete acquisitions, joint ventures and strategic partnerships; (iii) our ability to attract new participants and retain existing participants; (iv) the impact on our business from ongoing macroeconomic related challenges, including labor shortages, labor competition and inflation; (v) inspections, reviews, audits and investigations under the federal and state government programs, including any corrective action and adverse findings thereunder; (vi) legal proceedings, enforcement actions and litigation malpractice and privacy disputes, which are costly to defend; (vii) under our PACE contracts, we assume all of the risk that the cost of providing services will exceed our compensation; (viii) the dependence of our revenues upon a limited number of government payors; (ix) the risk that our submissions to government payors may contain inaccurate or unsupportable information including regarding risk adjustment scores of participants, subjecting us to repayment obligations or penalties; and (x) the impact on our business of renegotiation, non-renewal or termination of capitation agreements with government payors.

Forward-looking statements are 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. We advise you to not place undue reliance on forward-looking statements and to review our risk factors and other disclosures included in the reports we file or furnish with the Securities and Exchange Commission, including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.