Fiscal Year 2024 Third Quarter Earnings

Tuesday, May 7, 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 third 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 third 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, May 7th, 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 PACE, 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 gratitude to our colleagues, participants, government partners, and the investor community who support InnovAge.

I'd also like to thank those of you who attended our first Investor Day in late February. We believe it effectively re-introduced the company including the investment thesis, how we're different than other value-based care models, and this unique inflection point in the company's history given the internal transformation over the last two years.

The company's third quarter results were largely consistent with our expectations. We continue to see ongoing performance improvement in every facet of our operations which is driving greater stability in our financial results and increased confidence in our ability to deliver high-quality care and a great participant experience, while also growing our top and bottom lines. As discussed on prior earnings calls, we normally experience seasonality in the third quarter – and this year, it was exacerbated because of what we believe to be a few moment-in-time drivers, which I'll cover in a moment. Critically, when we look at the momentum of our business from the top down, we are pleased to see steady growth in demand for PACE services. We are confident in the industry tailwinds and the unique benefits to the stakeholders that PACE offers.

With respect to quarterly financials, we reported revenue of $193 million dollars for the quarter, an increase of approximately two percent compared to the second quarter, and center level contribution of $34 million dollars, which represents a 17.6 percent margin and is generally consistent with the second quarter. Adjusted EBITDA was $3.6 million dollars for the quarter. Importantly, in the quarter we incurred increased de novo losses as we're now open in Tampa and Orlando, and you'll recall last quarter's results included a one-time risk-adjustment true-up benefit, making the sequential progression less comparable. On a year over year basis, quarterly revenue has increased by approximately 12 percent, and Adjusted EBITDA is up $5.6 million dollars, from a quarterly loss of approximately $2 million dollars in the third quarter of fiscal year 2023. Census increased to 6,820, which represents a quarter over quarter improvement of approximately one percent. Overall, our results reflect solid performance in the areas of topline growth, medical cost management, center-level staffing costs and SG&A.

We remain focused on day-to-day execution and exiting fiscal year 2024 with solid earnings momentum. The portfolio of initiatives that we've launched over the past two years are creating tangible impact that we're seeing translate into earnings. As we discussed at our Investor Day, we continue to challenge ourselves to continuously identify new value creation opportunities at the center level with the goal of achieving an overall center level contribution margin of 20 percent or more over time. While we now operate 20 centers across six states including the opening of our Orlando center which occurred on April 1st, healthcare is delivered locally and

there are differentiated opportunities and challenges to address at each center. We are bringing best practices to centers and to departments within centers that we believe can be improved. We are pleased with our recent work in this area; we are starting to see the contribution margin impact; and we have confidence that we will achieve our future goals.

We also remain focused on our Five Pillar performance management framework which uses a balanced scorecard to assess our delivery of high-quality, compliant care in a financially responsible way. We use the Five Pillar metrics to track operational performance at the center and enterprise level and we link our management incentive program to the results. Our strong performance against our target metrics continued this quarter. As a couple of examples:

- Our participant experience, which is measured by Net Promoter Score, was 46 in fiscal year 2024 against a target of 35;
- Our proprietary quality composite score was 4.2, which is slightly above our target level of 4.0 out of 5.0 STARS.

We believe that continued strong performance in the pillars of employee engagement, participant satisfaction, care quality and compliance are an excellent leading indicator for future growth and financial performance.

Now turning to the details on the quarter:

You'll recall last quarter and during our investor day, we touched on anticipated third quarter seasonality. This quarter, seasonality was exacerbated by several moment-in-time factors:

We have continued to experience ongoing enrollment processing delays in Colorado in part due to the competing priorities of Medicaid redetermination. As a reminder, 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. While these delays do not affect the eligibility of potential participants, the protracted nature of the enrollment processing delays have resulted in some prospects opting to pursue other service options. We continue to work with the state to resolve these issues as quickly as possible.

Additionally, due to physician and nurse practitioner staffing vacancies and recruitment challenges in our Sacramento and San Bernadino centers, we made the proactive decision to temporarily slow our rate of enrollment, despite market demand that surpassed expectations, to ensure the workload of onboarding new enrollment matched our center primary care staffing levels. While serving more seniors remains a top priority, ensuring we deliver a high-quality participant experience is bedrock to our responsible growth strategy. We have now filled the open positions and have resumed normal enrollment tempos.

This year, we also experienced an unusually competitive environment due to the richness of Medicare Advantage supplemental benefits when compared to past annual enrollment periods. The amount has increased materially from years past and the breadth of where cash benefits can be spent has expanded as well. As a result, we believe this had a marginal impact in both our ability to enroll new participants and a higher number of existing participants who disenrolled for an alternative plan. We have strong conviction that the integrated and personalized nature of the PACE model offers a superior value proposition to frail seniors struggling to maintain their independence when compared to other Medicare Advantage options - and our enrollment and operation teams are working to educate our participants and potential participants on the benefits of PACE. We also believe that margin pressures which have recently materialized across the MA industry will result in a reduction of MA value-added benefits in 2025 which will only enhance our relative competitiveness.

Despite these temporary headwinds, the overall demand for services has continued to grow as evidenced by a sequential increase in sales qualified leads of 10% with the total number reaching over 1,600 leads in the third quarter. This underpins our ongoing confidence that far more individuals are interested in PACE than we are enrolling today.

On the de novo front, we're excited to announce that we are operational at our new Orlando center. Like Tampa, this new state of the art facility has the capacity 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 are hosting a grand opening on May 29th to bring awareness and to celebrate this important milestone in Orlando.

In our recently acquired Crenshaw California center, we were encouraged to see momentum build under our ownership as Q3 enrollment began to ramp in line with our expectations.

On the regulatory front, we are pleased to report that our post sanction monitoring in Colorado, which was initiated in January of 2023, has been closed out by CMS. We continue to engage with the state of Colorado to finalize the outstanding process improvements.

On our last call, we touched on the ongoing activities in our San Bernardino center with the California Department of Health Care Services. DHCS conducted their targeted medical review in March, and we await notification on a date for the exit interview.

Regarding Sacramento, we submitted proposed corrective actions to DHCS in March and at the beginning of this month, CMS officially closed its portion of the audit. We are awaiting feedback from DHCS.

Following resolution of the audits and corrective actions in California, we expect to resume discussions with the state regarding our Downey and Bakersfield expansion plans.

Turning to operating performance, we continue to see improvement in our management of external medical costs as evidenced by a sequential decrease in participant expense PMPM from $3,903 last quarter to $3,823 this quarter, which represents an approximate two percent improvement. The largest driver of our sequential improvement was the decrease of permanent placement nursing home housing costs.

As discussed on previous calls, our goal is to have our population reflect the population of the communities we serve. And these communities are made up of a mix of people that are living independently, those that are receiving some type of supportive housing, and those in an institutional setting. As we continue to enroll new participants who are living independently in the community, we're seeing a decrease in the percentage of our participants permanently residing in nursing homes. We believe this change in the composition of living situation demonstrates a modest improvement in risk mix, relative to where we were while under enrollment restrictions. Said differently, our mix is migrating back in line with the underlying assumptions used to derive our rates. Over time, improved mix should help offset external medical cost trends while supporting the independent living goals of CMS and our state partners.

Additionally, we've piloted an end-of-life comfort care program in Denver, which supports our participants with palliative care expertise and 24 / 7 access to our own team of nurses, as a means of improving participant experience while also reducing lower value external hospice costs. In addition to better coordination with our interdisciplinary care team and participant and family satisfaction, the program reduced external spend by 43 percent from the baseline in November, while improving overall quality of care. We are currently developing the business case to scale this program to other markets. Our portfolio of clinical value initiatives, or CVIs as we refer to them internally, are performing in line with our expectations. As you would expect, some are ahead of plan, and there are a few which were delayed - and we don't anticipate seeing the run rate benefits until fiscal year 2025.

Further, we're seeing improvement in our center-level staffing ratios, which has improved by approximately five percent relative to where we started the fiscal year, while holding our quality and compliance resources constant during a period with the same level of CMS and State auditing activity. Recall, center-level staffing ratios were negatively impacted by the effect sanctions had on our census and because of the additional internal and external resources required to meet the demands of the audits.

In summary, we believe we are continuing to improve the business every quarter. The combined effect of our broad set of initiatives in the areas of topline growth, cost management, quality, and compliance over the course of the past two years is accelerating as evidenced by our improving

results. We will continue our tireless efforts to make each center better every day as the centers are the heart of our business.

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 third quarter fiscal year 2024 financial performance, and insight into some of the trends we are seeing in the quarter. While it is still early in our margin improvement initiatives, we continue to track to our internal targets, and we are pleased with our progress and with the opportunity for additional margin recapture over time.

Starting with census, we served approximately 6,820 participants across 19 centers as of March 31, 2024, which represents quarter over quarter growth of 0.7 percent. We reported 20,360 member months in the third quarter, a 1.2 percent increase over the second quarter. This reflects the anticipated third quarter enrollment softness that Patrick discussed.

Total revenue of $193.1 million dollars increased 2.2 percent compared to the second quarter due primarily to an increase in member months coupled with an increase in Medicare capitation rates. This was partially offset by a California rate decrease of approximately 2.5 percent effective January 1st, 2024, and a one-time Medicare true up outside the regular payment cycle that was recorded in the second quarter.

We incurred $100 million dollars of external provider costs during the third quarter of fiscal 2024, a one percent decrease compared to the second quarter. The sequential decrease was primarily driven by lower permanent nursing facility utilization resulting in a decrease in cost per participant, partially offset by an increase in member months.

Cost of care, excluding depreciation and amortization, of $59.1 million dollars increased 8.8 percent compared to the second quarter. The increase was due to higher cost per participant coupled with an increase in member months.

The cost per participant increase was driven by:

- An increase in salaries wages and benefits due to higher headcount and increased wage rates associated with the annual reset of employee benefits and taxes.
- An increase in software license fees associated with a new pharmacy software program that we rolled out in January.
- De novo occupancy and administrative costs associated with our new Crenshaw and Bakersfield centers acquired in the ConcertoCare PACE acquisition, and

- Third party expenses associated with the annual Part D bid creation and retrospective coding review.

Center-level contribution margin, which we define as total revenue less external provider costs and cost of care, excluding depreciation and amortization, was $34 million dollars for the quarter compared to $33.6 million dollars in the second quarter. As a percentage of revenue, center-level contribution margin of 17.6 percent was relatively unchanged compared to 17.8 percent in the second quarter.

Sales and marketing expense was $7.2 million dollars, an increase of approximately $1.3 million dollars compared to the prior quarter. The increase was primarily due to increased headcount coupled with increased marketing spend for our newly opened Tampa center and recently acquired Crenshaw center.

Corporate, general and administrative expense increased to $27.5 million dollars; a $2.3 million dollar increase compared to the second quarter. The increase was primarily due to:

- An increase in benefits expense due to annual reset of employee benefits and taxes,
- An increase in bad debt,
- An increase in software license and maintenance expense, including user licensing costs associated with Epic, and
- An increase in third party legal expense.

The increase was partially offset by a decrease in costs associated with the Epic conversion that we completed in the second quarter.

Net loss was $5.9 million dollars compared to net loss of $3.8 million dollars in the second quarter. We reported a net loss per share of 4 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 net 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 $3.6 million dollars for the quarter, compared to $7.8 million dollars in the second quarter. The decrease was due to the one-time Medicare true up payment in the second quarter as well as the increase in de novo costs associated with Tampa, Orlando, and Crenshaw in the third quarter.

Our Adjusted EBITDA margin was 1.9 percent for the third quarter, compared to 4.1 percent in the second quarter.

De novo losses, which we define as net losses related to pre-opening and start-up ramp through the first 24 months of de novo operations, for the third quarter were $4.1 million and primarily related to the recently acquired Bakersfield and Crenshaw centers, and our centers in Florida. This compares to $2.2 million dollars of de novo loses in the second quarter.

Turning to our balance sheet, we ended the quarter with $54.1 million dollars in cash and cash equivalents plus $45.2 million dollars in short-term investments. We had $81.3 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 third quarter, we recorded cash flow from operations of $3.5 million dollars, and we had $450 thousand dollars of capital expenditures.

We are re-affirming our fiscal 2024 guidance which, as we said last quarter includes the ConcertoCare PACE 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 recently acquired Bakersfield and Crenshaw centers.

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 the day-to-day operational execution and exiting fiscal 2024 with solid earnings momentum.

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 new and 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 payor capabilities, implement clinical value initiatives and strengthen enterprise functions; the potential effects of the macro-economic environment; our expectations with respect to audits, 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, including our ability to obtain licenses to open our de novo centers in Downey and Bakersfield, California, and our ability to ramp up our de novo centers in Florida; (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, such as the audit of our Sacramento, California center and the targeted medical review of our San Bernardino, California center, 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) our ability to compete in the healthcare industry, including as a result of new or growing market participants; (xiii) the difficulty to predict our future results, which could cause such results to fall below any guidance we provide; (xiv) the impact of state and federal efforts to reduce healthcare spending; (xv) the effects of a pandemic, epidemic or outbreak of an infectious disease, such as COVID-19; (xvi) our dependence on our senior management team and other key employees; (xvii) the impact of failures by our suppliers or limitations on our ability to access new technology or medical products; (xviii) the concentration of our presence in Colorado; (xix) our ability to manage our operations effectively, execute our business plan, maintain effective levels of service and participant satisfaction and adequately address competitive challenges; (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.