LifeStance Third Quarter 2023 Earnings Script

Monica Prokocki, VP of Investor Relations

Good morning, everyone, and welcome to LifeStance Health's third quarter 2023 earnings conference call.

I'm Monica Prokocki, Vice President of Investor Relations. Joining me today are Ken Burdick, Chief Executive Officer; Dave Bourdon, Chief Financial Officer; and Danish Qureshi, Chief Operating Officer.

We issued the earnings release and presentation before the market opened this morning. Both are available on the Investor Relations section of our website, investor.lifestance.com. In addition, a replay of this conference call will be available following the call.

Before turning the call over to management for their prepared remarks, please direct your attention to the disclaimers about forward-looking statements included in the earnings press release and SEC filings.

Today's remarks contain forward-looking statements, including statements about our financial performance outlook, business model and strategy. Those statements involve risks, uncertainties, and other factors, as noted in our periodic filings with the SEC that could cause actual results to differ materially.

In addition, please note that we report results using non-GAAP financial measures, which we believe provide additional information for investors to help facilitate comparison of current and past performance. A reconciliation to the most directly comparable GAAP measures is included in the earnings press release tables and presentation appendix.

Unless otherwise noted, all results are compared to the comparable period in the prior year. At this time, I'll turn the call over to Ken Burdick, CEO of LifeStance. Ken?

Ken Burdick, Chairman & CEO

Thanks, Monica, and thank you all for joining us today.

The work that we have been doing to invest in the business, fortify our foundation and standardize our operations is beginning to bear fruit both operationally and financially. This quarter, we met or exceeded our expectations across all key financial metrics, and, for the first time in our young history as a public company, we are raising our guidance for each of these metrics for full year 2023.

As I reflect on my first year at LifeStance, three themes rise to the top of my list.

First, after having spent 40 years on the payor side, I'm struck by the degree to which payors have underinvested in mental health, and the access issues that have resulted. Far too many individuals are still required to self-pay for their outpatient mental health treatment.

Despite the headlines, the ever-increasing demand for outpatient mental health treatment, and unprecedented levels of depression, anxiety and suicide, we as a country continue to under-invest in building clinical capacity and funding clinical research for mental healthcare.

Second, I feel stronger than ever that the founders of LifeStance developed the right business model—in-network mental healthcare delivered both in-person and virtually by employed clinicians with a broad physical footprint and diverse professional credentials and experience.

Third, I continue to be incredibly impressed and inspired by the dedication and passion of our employees throughout the organization. Their connection to our purpose and commitment to our mission is evident in every conversation I have had since my first day at LifeStance.

We are resolutely committed to putting patients and clinicians at the forefront of everything we do. We spend a great deal of time speaking with you about financial metrics; however, I assure you that we never lose sight of the reason this business was founded—to make outpatient mental healthcare more accessible, affordable and unified with physical healthcare so individuals are treated holistically. While we are focused on initiatives to improve our operational performance, it is important to recognize that our clinicians' delivery of care to our patients has been and continues to be exceptional.

As a result, our patient Net Promoter Score is over 80, and our average reviews for all LifeStance centers across Google searches are currently at 4.5 out of 5 stars, reflecting the quality of our patient experience.

In addition to patient satisfaction, now that we are on a single EHR, we are working to aggregate our clinical results and share them to quantify our clinical outcomes and the positive impact on our patients' mental health.

I would also like to note the steps we are taking toward a more deliberate and selective payor engagement model. We are still in the early stages of this strategy. You will recall that in the first phase, we focused on eliminating low-volume payor contracts to reduce the administrative burden on the organization. Earlier this year, we terminated the bottom 30% or so of our hundreds of payor contracts with minimal to no impact on visit volume. We will continue to actively evaluate and streamline the number of payor contracts to allow our internal teams to operate more efficiently.

We are also in the midst of a second phase in our payor strategy, in which we are becoming more assertive in demanding appropriate reimbursement for our services. We have begun to see positive early results and are focused on aligning only with payor partners who share our vision of expanding access to in-network mental healthcare, and who invest in that vision with rates and terms commensurate with the value that LifeStance clinicians provide.

Before closing, I would like to provide an update on the shareholder lawsuit. While we expressly deny the claims alleged in the lawsuit, we have decided to enter into a settlement to avoid incurring additional legal expense and management distraction from continued litigation. We will be able to fund this settlement with our existing financial capacity without raising capital, and this will not impair our ability to make the necessary investments to build a great business.

We believe that putting this matter behind us is in the best interests of the company and will ensure that we can remain focused on our core mission of caring for our patients and building a business that addresses one of the greatest needs in our country today—affordable and accessible mental health care.

With that, I will turn it over to Dave to provide additional commentary on our financial performance and outlook. Dave?

Dave Bourdon, Chief Financial Officer

Thanks, Ken.

Like Ken, I am pleased with the team's solid operational and financial performance.

In the third quarter, we achieved robust performance in our top-line results with revenue of $263 million, representing growth of 21% year-over-year. This outperformance was primarily driven by increased visit volumes as a result of better-than-expected productivity during the vacation season.

Visit volumes of 1,714,000 increased 20% year-over-year, primarily driven by higher clinician count and higher productivity.

Total revenue per visit increased 1% year-over-year to $153, primarily driven by modest payor rate increases. For the full year, rates continue to be aligned with our expectations of a low single-digit increase year-over-year.

When it comes to profitability, the outperformance on revenue flowed through to Center Margin. Center Margin of $76 million in the quarter increased by 26% year-over-year. Adjusted EBITDA of $15 million was consistent with our expectations.

Turning to liquidity—in the third quarter, free cash flow was negative $35 million. This was primarily driven by approximately $20 million from intentionally holding payor claims, and approximately $8 million in legal costs paid related to the shareholder lawsuit.

As expected, DSO increased sequentially from 43 days to 52 days. As announced on our last call, we anticipated an increase in DSO this quarter as we chose to hold claims for several large payors due to positive updates from rate negotiations. We decided to hold claims until the payors had loaded the new rates into their systems to avoid underpayment and excess rework on over one hundred thousand claims. We continue to expect DSO to meaningfully improve in the fourth quarter and have already seen a significant improvement in October as we released the held claims. We are now on track to see DSO that is closer to Q2 levels by the end of the year.

We exited the third quarter with cash of $43 million and net long-term debt of $248 million. At the end of Q3, we had additional debt capacity from a delayed-draw term loan of $41 million as well as a $50 million revolving debt facility.

As Ken touched on earlier, we recently entered into a settlement of the shareholder lawsuit to put this matter behind us and avoid the cost and the distraction of continued litigation.

I’ll now share the P&L and cash impacts of the litigation and the settlement.

First, the settlement was $50 million, with $20 million of that covered by insurance. In addition to the settlement, we expect to have approximately $20 million in legal fees related to the litigation. From a P&L perspective, in the third quarter, this settlement, plus legal expenses of $14 million, resulted in a $44 million expense for LifeStance. Prior to this, we incurred approximately $3 million in legal expenses in Q2 and expect around $2 to $3 million more in the fourth quarter.

In terms of cash, the total outlay will be $50 million. In the second and third quarters, we paid approximately $8 million in legal fees. In the fourth quarter, we expect to pay approximately $17 million which is comprised of $5 million for the settlement, and $12 million in legal fees. Finally, in the first quarter of 2024, we will be responsible for the final $25 million settlement payment.

We have sufficient capacity to fund these payments and run the company until we reach positive free cash flow, and we do not intend to raise additional debt or equity capital.

In terms of our outlook for 2023, we are narrowing our full year revenue range and raising it by $10 million at the midpoint, to $1,030 to $1,040 million. The midpoint of this guidance puts us at approximately 20% revenue growth. This is above our original mid-teens guidance and was driven by the power of our organic growth engine combined with clinician productivity.

We are narrowing our full year Center Margin range and raising it by $6 million at the midpoint, to $292 to $300 million. We are narrowing our full year Adjusted EBITDA guidance range and raising it by $2 million at the midpoint to $56 to $60 million.

In the fourth quarter, we expect Revenue of $255 to $265 million, Center Margin of $73 to $81 million, and Adjusted EBITDA of $17 to $21 million. As a reminder, there is seasonality reflected in our fourth quarter guidance as a result of the holidays, which has historically resulted in lower total clinician capacity in the quarter.

Now I'd like to spend a minute discussing 2024. We are still conducting our business planning process and therefore it is premature to provide specifics on next year's guidance. However, I wanted to give you some perspective on our thinking.

We continue to expect mid-teens organic revenue growth driven primarily by growth in clinician count and higher rates per visit. As with the initial 2023 full year guidance, the mid-teens growth does not include any assumptions for improved clinician productivity.

We expect to see margin expansion from operating leverage and modest contribution from rate improvement. As I mentioned in the second quarter earnings call, the margin improvement in 2024 and 2025 will not be linear and we anticipate greater margin expansion in 2025, as we will have the benefit of a full year of returns on our foundational investments. We continue to expect to exit 2025 with double-digit Adjusted EBITDA margins.

In regard to free cash flow, even with the $25 million settlement payment in the first quarter next year, we expect to approach positive free cash flow in 2024.

Before I turn it over to Danish, I would like to say that the unprecedented demand for mental health access and affordability will continue to provide a tailwind for LifeStance. We look forward to sharing our 2024 guidance with you on our next earnings call.

With that, I'll turn it over to Danish for additional color with respect to operations.

Danish Qureshi, President & COO

Thank you, Dave.

This year we have focused on solidifying the foundation of our business. We have made significant upgrades in our senior operations leadership across the country, and brought far more focus, prioritization and data-driven decision-making to the organization in 2023. We have also simplified and streamlined the business, setting us up for operating leverage in 2024 and beyond.

As an example, we continued to evaluate the in-person usage levels across our centers to identify where we have opportunities for consolidation.

On our last earnings call, we announced that we had consolidated 36 centers with little to no disruption to our patients or clinicians. Since then, we identified an additional 35 to 40 centers for consolidation, bringing the total to over 70 centers in 2023.

This consolidation project is largely complete, and we feel that our real estate footprint is now better optimized. Our ability to deliver in-person care across more than 500 locations continues to be a key differentiator.

In terms of de novos, we also continue to intentionally moderate our pace of openings. We remain on track to open no more than 36 this year and expect to open fewer de novos next year. Optimizing our real estate footprint will allow us to drive margin improvement over time as we continue to scale.

Turning to growth—in terms of net clinician adds, we grew by 286 in the third quarter, bringing our total to 6,418 clinicians, an increase of 18% year-over-year. Importantly, this growth remains 100% organic. This is a record number of organic net clinician adds in a single quarter and is a testament to the amazing work performed by our recruiting and operations teams, as well as the strength of our value proposition to clinicians.

As a reminder, there is variability in clinician starts throughout the year and we do expect a lower number of net clinician adds in Q4.

In terms of productivity, we continue to drive operational discipline to optimize utilization of clinician schedules at the top, middle and bottom of the patient funnel.

At the top of the funnel, we are attracting new patients above the growth of our clinician base, demonstrated by our growing waitlists for services. Our boots-on-the-ground primary care referral team continues to expand local relationships, in conjunction with continued growth in online organic patient traffic and increased brand awareness.

Next, at the middle of the funnel, we continue to improve patient matching and scheduling, both over the phone and through our online digital capabilities, leading to a higher number of inbound patient inquiries converting to scheduled appointments.

Finally, at the bottom of the funnel, a higher number of scheduled appointments are converting to completed visits, with our cancellation and no-show rates improving from 10.4% in Q2 to 9.6% in Q3. This represents 5 points of improvement from a year ago, which has had a significant positive impact on the ability of our clinicians to use their time productively.

As a reminder, late cancellations and no-shows are a loss to LifeStance, to clinicians, and to patients. Visits that are scheduled but not completed result in lower revenue to LifeStance, an unfilled appointment slot and lower compensation to clinicians, and reduced access to care for patients who could have received much-needed mental health services during that time. They are a net negative to all parties, and we will continue to focus on reducing patient late cancellations and no-shows.

Over the last year, our efforts to optimize utilization at the top, middle, and bottom of the patient funnel have been the primary driver of productivity improvements. While we will continue to focus on operational enhancements in this area, we expect benefits to be more incremental going forward given the progress made so far.

We therefore feel that now we can shift our focus to the other side of the productivity equation, capacity. It is still early but we are exploring initiatives to grow overall clinician capacity and will share more on this on future earnings calls.

As we continue to focus on our growth priorities of net clinician adds and productivity, our top priority remains delivering an amazing patient and clinician experience.

For example, we know how complex understanding health insurance can be for patients, including differentiating between copays, deductibles, patient responsibilities, in-network versus out-of-network benefits, and appointment no-show or late cancellation fees. To that end, we have continued to invest in our billing solutions call center to improve the overall experience and help patients get answers to their questions faster.

Additionally, we are piloting a digital patient check-in tool. If successful, this tool will allow us to collect and verify patient insurance information upfront, as well as allow patients to pay their copays and past due balances more easily. This will reduce stress for our patients and manual complexity for our operations teams, delivering an improved patient experience and streamlined operations.

We are also refining our new nationwide phone system and increasing our front office staffing levels to create better support for our clinicians locally and to ensure that our patients have easier access to our staff.

In closing, I am impressed with what our teams have accomplished this year. We have made progress in our two-year plan to strengthen and solidify the foundation of our business, whether that be through improvements in the utilization of clinician schedules; moving to a single EHR, phone system, and online booking tool; optimization of our real estate footprint; or the myriad of other behind-the-scenes ways that we are driving a more efficient and standardized operating model. All of this is a testament to the hard work of our clinicians and teammates around the country.

With that, I'll turn it back over to Ken for his closing remarks.

Ken Burdick, Chief Executive Officer

Thank you, Danish.

In closing, I'm proud of the team's progress this year. This is the fourth straight quarter that LifeStance has met or exceeded expectations, and with continued disciplined execution, we are well-positioned to deliver on our full-year commitments. In addition to achieving solid financial results, we also continued to attract high-quality clinical and operational talent.

The heavy lifting that we are doing this year and next to streamline and standardize our systems and processes was sorely needed after nearly 100 acquisitions over six years. I am encouraged by our progress and momentum, yet recognize that our work is far from done. I look forward to continuing to demonstrate the tangible benefits of this work when we share our 2024 guidance.

We will now take your questions. Operator?