LifeStance Fourth Quarter 2022 Earnings Script

Monica Prokocki, VP of Investor Relations

Good morning, everyone, and welcome to LifeStance Health's fourth quarter 2022 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 prior 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 prior-year comparative period. At this time, I'll turn the call over to Ken Burdick, CEO of LifeStance. Ken?

Ken Burdick, Chairman & CEO

Good morning and thank you for joining us today.

I would like to start by highlighting the tremendous opportunity ahead. LifeStance is leveraging our nationwide, market-leading outpatient platform of over 5,600 clinicians with the mission of increasing access to trusted, affordable, and personalized mental healthcare.

Our diverse mix of clinicians offers a multidisciplinary approach that allows us to treat all types of mental health diagnoses through our hybrid model of virtual and in-person care. We remain focused on reinforcing the strategic advantages offered by our hybrid model which gives both our providers and patients highly desired flexibility. Importantly, as the Public Health Emergency, or PHE, ends in May of this year, we are well positioned to support patients by compliantly providing care both virtually and in our centers.

We are continuing to expand access to affordable, high-quality care by providing mental health services through in-network commercial reimbursement. In 2022, our clinicians treated over 680,000 unique patients with approximately 5.7 million visits.

Through the company's early years of tremendous growth, we've been in an all-out sprint. Now, we're focused on building scalable processes and systems, not only to support the level of growth we've already attained but to prepare LifeStance for the huge opportunity in front of us.

As previously shared, we are committed to enhancing our operational performance and delivering profitable and sustainable growth. To that end, we continue to focus on execution—the blocking and tackling required to operate a growing business at scale.

In our last earnings call, I highlighted several areas that will receive greater emphasis at LifeStance going forward.

First, we will focus on long-term profitability, capital discipline and generating free cash flow.

For example, to improve our operating leverage and cash generation, we are in the process of evaluating LifeStance's over 600 physical centers to optimize our real estate spend. We expect to further moderate de novo growth and consolidate approximately 30 to 40 offices, with minimal to no disruption to our clinicians or patients due to the close proximity of some of our offices.

Second, we will make strategic investments in enterprise-level scalable infrastructure over the next few years, beginning this year. As a reminder, when we refer to scalable infrastructure, we mean strengthening our underlying platform through end-to-end process optimization, standardization, and automation to reduce manual processes.

Third, as we focus on simplifying administrative complexity, our payor strategy will become more selective. As a reminder, the bottom 50% of our payor contracts represent less than 6% of our visit volume. By the end of this year, our goal is to reduce our number of payor contracts by approximately 25%. This will reduce administrative burden while allowing us to better align with payor partners who share and invest in our vision and mission of expanding access to high-quality, affordable mental healthcare.

Fourth, we continue to shift toward organic growth versus acquired growth. In 2022, over 80% of our gross clinician adds were hired rather than acquired. Acquisitions were absolutely crucial to building scale in LifeStance's early years, but with a broad footprint now in place across 34 states, we are hyper-focused on the organic growth opportunity in this massive market.

Finally, I would like to highlight an encouraging data point that reflects initial progress in strengthening our operational performance. In the fourth quarter, we saw benefits to our free cash flow as a direct result of the investments we made in our revenue cycle management process. The 8-day improvement in days sales outstanding, or DSO, brought this quarter's DSO to 40 days, down from last quarter's 48 days.

Turning to financial results for the fourth quarter of 2022, revenue of $229 million and Center Margin of $63 million exceeded our expectations. Adjusted EBITDA of $10 million was at the high end of our guidance range for the fourth quarter. While we are encouraged by these recent results, we recognize that there is much more work to do before we achieve meaningful and sustainable improvement in our operational and financial performance.

In terms of our outlook, as we have commented previously, the next two years will be focused on making strategic investments in our business to fortify our operating platform. This important but unglamorous work to standardize and simplify our end-to-end processes will enable us to introduce tools that will improve the consistency, efficiency and capacity of our operations. In his prepared remarks, Dave will outline our 2023 expectations and provide specifics on the strategic investments that will begin this year.

Consistent with what we committed to last quarter, Dave will also share our multi-year guidance which serves as a bridge to our future profitability and cash flow generation. We will strengthen the foundation in 2023 and 2024 to set up LifeStance for success in the long term.

In closing, I remain bullish about the opportunity in front of us. I am also realistic about the amount of enterprise-wide focus and effort that will be required to fundamentally improve our business. I am confident that our newly launched Business Transformation Office will drive the change management processes required in an organization of our size. I have led this type of transformation previously in my career, and I am confident that we have the right people, strategy and multi-year plan to effectively position LifeStance for the robust opportunities that lie ahead.

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

Dave Bourdon, Chief Financial Officer

Thank you, Ken.

I am very pleased to participate in my first LifeStance earnings call. I joined this company because of its unique market position, compelling mission, significant growth opportunity, and talented team. I look forward to working with our team to increase our financial discipline and improve our annual and multi-year planning processes so that we can consistently deliver on our commitments.

Now, turning to our fourth quarter performance. LifeStance delivered strong top line results. Revenue of $229 million increased 21% year-over-year, with the outperformance in the quarter primarily driven by higher than expected clinician count and productivity.

Visit volumes of 1,487,000 increased 16% year-over year. Total revenue per visit increased 4% year-over year to $154. Our revenue is a function of visit volumes and total revenue per visit. Therefore, we look forward to reporting these metrics on a quarterly basis going forward. Historical information, beginning with the first quarter of 2022, is provided in the earnings materials posted to our website.

For the full year, we delivered revenue of $860 million, up 29% year-over-year.

Additionally, the better-than-expected top line results flowed through to Center Margin. Center Margin of $63 million in the quarter increased by 16% year over year. Full year Center Margin of $237 million grew 18% year-over-year.

Adjusted EBITDA of $10 million in the quarter was at the high end of our guidance range, and included investments across the business such as growing our revenue cycle management team. These investments were accelerated, and as a result, G&A was higher than previously expected. For the full year, adjusted EBITDA was $53 million, representing 6.1% of revenue.

Turning to liquidity-- in the fourth quarter, we generated positive free cash flow of $26 million, and $36 million in cash from operating activities. As Ken mentioned, these positive improvements in cash flow were driven by improved collections. We are encouraged by this progress and see it as a tangible return on our investment in this team. Our DSO fell by 8 days quarter over quarter, and I'd like to highlight that each one of these days represents roughly $2.5 million. Additionally, capital expenditures were consistent with our strategy of moderating the pace of de novo center openings.

We exited the quarter with cash of $109 million and net long-term debt of $225 million. We have additional debt capacity from a delayed-draw term loan of $66 million as well as a $50 million revolving debt facility, providing us with sufficient financial flexibility.

In terms of our outlook for 2023, we expect full year revenue of $980 million to $1.02 billion, Center Margin of $270 to $290 million, and Adjusted EBITDA of $50 to $62 million.

Our annual guidance assumes year-over-year revenue growth driven primarily by higher clinicians and visits combined with a modest increase in the total revenue per visit. Otherwise, we are assuming generally consistent operational performance year-over-year. Our guidance also contemplates a revenue split of roughly 50/50 in the first and second half of the year due to seasonality. We expect G&A to grow at a higher rate than revenue as we invest in strengthening the business, which is depressing margins year-over-year.

For the first quarter, we expect revenue of $242 to $252 million, Center Margin of $62 to $69 million, and Adjusted EBITDA of $7 to $12 million.

We expect first quarter adjusted EBITDA margins to be down sequentially due to payroll taxes and seasonality related to some of our services due to the reset of patient deductibles. We also expect incremental G&A expenses in the first quarter, driven by additional investments to support the business. We then expect margins to improve for the remainder of the year, resulting in modestly more earnings in the second half versus the first half of the year.

Additionally, we expect stock-based compensation expense of approximately $90 to $110 million in 2023, including approximately $25 million from the new 2023 grants.

For the year, we are expecting M&A spend of approximately $40 million, inclusive of up to $20 million in earnouts from prior years' acquisitions.

We continue to have a strong balance sheet and do not anticipate the need to raise capital in 2023. We expect to have negative free cash flow in the first half of the year, primarily driven by two factors: first, compensation costs such as higher payroll taxes, bonus payments and the funding of the 401(k); and second, temporarily higher DSO driven by an increase in patient responsibility as deductibles reset in January. We expect to generate positive free cash flow in the second half of the year with the absence of these first half costs, along with DSO improving from first quarter levels.

As Ken highlighted, we believe it's imperative to make strategic investments in those areas which will deliver significant long-term benefits that enable LifeStance to better serve our patients, clinicians and team members, while achieving operating leverage as we continue to grow.

We have identified three critical investments that will occur over the next 24 to 36 months. These investments are (1) implementing an HRIS system to effectively manage the entire lifecycle of our employees, (2) implementing a technology platform that enables credentialing and onboarding of clinicians, and (3) enhancing our electronic health record or EHR experience. We will identify the non-recurring spend for these strategic initiatives as a discrete add-back item to calculate Adjusted EBITDA. Once implemented, the ongoing costs will come through as G&A.

We are in the planning and implementation phases of the HRIS and the technology platform that supports credentialing and onboarding. We expect those to be completed in the next 12 to 18 months with a cost of approximately $6 to $8 million. Of this, $2.5 to $3.5 million will be recognized as G&A expenses with the remainder in capex. We anticipate that the majority of the investment will be incurred this year.

The EHR initiative is in the very early stages of discovery. We expect to use most of 2023 to evaluate a range of options, from collaborating with our current vendor to implementing an alternative vendor solution. We will update you when we provide 2024 guidance on our path forward, estimated costs and timeline for the EHR initiative.

All in all, 2023 is going to be a busy year. We are ambitious, we are committed, and we are going to execute on our key initiatives. We know there is significant growth ahead, and we are building this company for a long and bright future. We will make the necessary investments along the way to ensure we fully capture that opportunity.

In regards to our outlook through 2025, we expect organic revenue to deliver mid-teens annual growth for the next two to three years, with potential future M&A being incremental to that level of growth.

We expect material Adjusted EBITDA margin expansion in 2024 and 2025 with a trajectory to double digit margins by the end of 2025. The improvement from current levels will be driven by rate improvement with payors, operating leverage, and growth of higher margin mental health offerings, such as neuropsych testing and group therapy.

We expect to be free cash flow positive for 2025 to fund both organic as well as moderate M&A growth.

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

Danish Qureshi, President & COO

Thank you, Dave. As mentioned on our last earnings call, we have aligned our teams around two business priorities: 1) clinician growth and 2) clinician productivity.

In terms of clinician growth, we saw 200 net clinician adds in the fourth quarter, bringing our total to 5,631, an increase of approximately 18% year-over-year. Importantly, this growth was approximately 80% organic.

Regarding productivity, we saw our clinician capacity, or the time clinicians make available to see patients, trend relatively in-line with the previous quarter.

In terms of utilization, or our ability to fill clinician time with patients, we continued driving operational discipline with a focus on the top, middle, and bottom of the patient funnel.

At the top of the funnel, we made enhancements to our primary care referral team, organic search traffic, internal clinician referrals, and enterprise referral partnerships. These actions delivered improvements in attracting new patients.

Second, at the middle of the funnel, in terms of converting patients to scheduled appointments, we continue to leverage our digital capabilities to improve patient matching via our online booking experience, OBIE. By 2022 year-end, OBIE was live in 20 states and we remain on pace for a full national rollout by mid-year.

Additionally, we enhanced our overall user experience through better online provider profiles, reduced scheduling complexity, and enhancements to our phone intake processes, all of which have led to improvements at the middle of the funnel.

Finally, at the bottom of the funnel, in terms of scheduled appointments converting to completed visits, our cancellation rates improved by half a point in the fourth quarter.

All of these improvements at the top, middle and bottom funnel contributed to better-than-expected productivity in the fourth quarter.

Turning to our hybrid model—as Ken mentioned, the PHE is ending on May 11, and we expect this will further magnify the competitive differentiation of our hybrid offering. LifeStance can seamlessly provide services even as PHE winds down and in-person requirements resume. To avoid disruption in our patients’ care, our Chief Medical Officer has set forth a plan that meets the in-person requirements for the prescribing of controlled substances.

We believe our hybrid model positions us well to capture patient preferences for both in-person and virtual visits, including increasing demand for in-person care. We provide our patients with the highest degree of flexibility, and our NPS score of 78 in 2022 reflects the quality of our patient experience.

Turning to real estate, physical centers remain a core part of our hybrid strategy. However, we see opportunities to optimize our existing footprint. We looked at factors like in-person usage of each center and proximity to other locations, to allow us to leverage our occupancy costs and allocate resources in a thoughtful and efficient way.

As a result, we plan to consolidate 30 to 40 of our existing locations while slowing our pace of de novo openings to 40 to 45 in 2023, down from 90 last year. Importantly, these efforts will allow for continued clinician adds and cause minimal to no disruption to clinicians and patients.

In closing, I wanted to thank all of the operations, shared services, and clinical team members that have helped drive improvements across the foundation of our business. I'm pleased at some of the early progress we have made together in my two quarters as Chief Operating Officer, however I am fully aware that there is much more opportunity for improvement ahead as we continue to remain focused on our top priorities.

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

Ken Burdick, Chief Executive Officer

Thank you, Danish.

In closing, we are pleased that we concluded the year on a positive note. We are encouraged by the early signs of improvement but fully recognize that we have much work ahead. Our focus remains on streamlining and standardizing our business over the next two years, which will pave the way for profitable and sustainable growth, and long-term value creation for our shareholders.

I would also like to take a moment to thank the employees of LifeStance for their dedication and commitment to our patients, to our operational transformation and to our mission to improve access to high quality, affordable mental healthcare.

We will now take your questions.

Operator?