LifeStance Second Quarter 2022 Earnings Script

Monica Prokocki, VP of Investor Relations

Good afternoon, everyone, and welcome to LifeStance Health's second quarter 2022 earnings conference call.

I'm Monica Prokocki, Vice President of Investor Relations. Joining me today are Mike Lester, Chief Executive Officer; Danish Qureshi, Chief Operating Officer; and Mike Bruff, Chief Financial Officer.

We issued the earnings release and presentation after the market close today. 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.

Those statements involve risks, uncertainties, and other factors, including the possible future impact of the COVID-19 pandemic on our business 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 Mike Lester, CEO of LifeStance. Mike?

Michael K. Lester, Chairman, President & CEO

Thank you, Monica, and thanks to all of you for joining us today.

To begin, I would like to emphasize the importance of our mission of improving access to trusted, affordable, and personalized mental healthcare.

We are playing an integral role in the expansion of access to and delivery of personalized mental healthcare. In the rapidly changing U.S. healthcare environment, we have demonstrated that we can provide solutions, at scale, to meet individual needs in-person or via telehealth. Fundamentally, we serve patients where they are and when they need us. That is a key driver of our success and the continued expansion of demand we are seeing.

LifeStance is committed to helping people lead healthier, more fulfilling lives as one of the country's largest outpatient providers of in-person and virtual mental healthcare.

In recent weeks, we have seen strong market validation of our hybrid business model through the acquisition of one of our primary care counterparts in the tech-enabled, multi-site provider space. This event highlighted the value and importance of innovative, patient-focused health care businesses to enhance the speed and efficacy of health care delivery relative to traditional providers while delivering a differentiated value proposition to payors, clinicians, and patients.

The hybrid, tech-enabled, patient-focused model is at the heart of what we do at LifeStance in the behavioral health space and continues to resonate with the market. We often refer to LifeStance as "primary care for your mind." We are focused on building the company for the long term to deliver on our mission of providing access to affordable, high-quality care through our hybrid delivery model. We are laser-focused on delivering the best care for our patients through our network of over five thousand W-2 employed, licensed mental health clinicians and a technology platform focused on providing clinicians and patients with a seamless experience.

Innovative industry leaders and disruptors have recognized the fundamental value of our mission, our model, and our team. We are continuously engaged in discussions with potential business partners to expand access to high quality mental health services, which is so critical now as our country faces a growing mental health crisis.

The need for access to mental healthcare has reached unprecedented levels, as depression and anxiety have increased by 4 fold in the last two years, and every 11 minutes, an American dies by suicide. We focus on our mission every day to meet the patient demand in the marketplace and to provide desperately needed mental healthcare services to patients across the country.

Turning to results, this was a solid quarter for LifeStance. We continue to see strong demand for our services and consistent execution by the team, which was reflected in our results. Revenue for the second quarter was $210 million, representing growth of 31%.

As we have noted previously, revenue growth is primarily driven by our total clinician growth. In the second quarter, we grew our net clinician base to 5,226, representing growth of 31% compared with the prior year and in line with our expectations.

We continue to focus on balancing growth, profitability, and liquidity considerations. We aim to consistently generate the profitability necessary to fund our growth for the long term. In the second quarter, we grew Center Margin to $60 million, or 28.5% of revenue, and Adjusted EBITDA to $15 million, or 7.0% of revenue, reflective of our focus on long-term margin expansion. By remaining disciplined in scaling our costs, we will improve leverage in our operating expenses while continuing to make key investments in scalable infrastructure.

Turning to the full year, we now expect 2022 Revenue and Center Margin toward the bottom end of our previously guided ranges of $865 to $885 million and $240 to $255 million, respectively, due to removing slightly more than one business day each from June, July, and August as a result of incremental clinician time off, with no other changes to our guidance assumptions.

Given pent-up demand for travel as pandemic restrictions relaxed, we found that clinicians took more time off in June relative to our planning expectations. We believe this impacted revenue by approximately $4 million in the second quarter. As a result, we have decided to carry that seasonality assumption forward into July and August to account for additional summer vacations. We believe the impact of this adjustment represents approximately $8 million in the back half of the year.

For 2022 Adjusted EBITDA, we are reaffirming our original guidance range of $63 to $67 million. We continue to focus our planned investments to grow and optimize our clinician base while continuing to drive leverage in our operating costs.

Turning to the recent COO transition. We announced in the second quarter that Gwen Booth retired from her role as Chief Operating Officer here at LifeStance, and that Danish Qureshi, our Chief Growth Officer, would succeed her in that role.

First, I would like to thank Gwen, who co-founded the company in 2017 with Danish and me, and who served as our COO since then. Gwen played an integral role in building our organization to what it is today. When Gwen retired from her position as COO, I was delighted that she agreed to become the inaugural Executive Director of the LifeStance Health Foundation, which is focused on awarding grants and scholarships to non-profit partners that improve mental health access for under-represented groups.

Danish was appointed as our next COO, effective July 1st, and has already begun a nationwide review of our operations. Many of you know Danish, a founding member of the LifeStance leadership team, who is highly qualified as we transition beyond the entrepreneurial growth stage to scale the company and optimize our overall operational and financial performance.

Danish has an exceptional track record of translating differentiated strategy into strong operating results, and I am confident in his leadership abilities to execute on our mission.

He will be sharing some of his initial observations about areas of opportunity in a few minutes. Danish is also playing a key role in updating our long-range strategic plan over the coming months.

Turning to the Foundation, the LifeStance Health Foundation was established in 2021 to award grants and scholarships to organizations that share LifeStance's vision to improve mental health access.

In the second quarter, we granted an award to the Trevor Project as part of our celebration of Pride Month in June, as a matching donation for local team fundraising for the organization. The Trevor Project is the world's largest suicide prevention and crisis intervention organization for LGBTQIA+ youth.

Also, through the Foundation, we are working with the American Foundation for Suicide Prevention to increase support for the new 988 crisis response line.

In closing—We have positive momentum in the marketplace, driven by a compelling patient value proposition, a steadily expanding clinician population and solid execution of our business.

I am confident in the long-term trajectory of the business, given our sustainable competitive advantages and the team that we have in place.

Danish?

Danish Qureshi, Chief Operating Officer

Thank you, Mike.

In my new role as COO, I spent my first few weeks doing three things:

First, meeting with our clinicians to learn how we can improve the support we provide to them,

Second, meeting with our operations teams to identify areas of opportunity as we continue to grow and scale, and

Third, diving deeper into our operational data to understand key trends and use that information to better drive our business going forward.

These activities have energized me around the immense opportunity we have in front of us, as well as reminded me of the critical role LifeStance plays as a leader in bringing mental health solutions to our patients nationwide.

Let me first start by providing a quick update on our second quarter operating results, as well as our core planning assumptions for the back half of 2022.

In the second quarter, we continued our intentional focus on deepening our presence in our existing 32 states. Though we will continue to selectively evaluate entry into new states in the back half of 2022, and currently anticipate one to two new state entries, we plan to focus the majority of our attention on building density in our existing markets to further enjoy the benefits of scale and begin driving operational leverage.

As we have stated previously, clinicians remain our primary growth driver. In the second quarter, we grew our clinician base nationwide to 5,226, an increase of 237 net clinicians. Importantly, we achieved this result while continuing to shift our focus toward more organic growth. Year-to-date, over 70% of our gross clinician adds have been brought on board via our industry-leading recruiting engine, and we expect that mix to continue to shift more organic in the back half of the year.

In terms of de novos, we opened 27 de novo centers in the second quarter to bolster our physical presence, bringing our total year-to-date to 68, and allowing us to pass a new milestone: over 600 centers operating nationwide. While we remain committed to opening additional de novo centers as part of our differentiated hybrid model, as previously communicated, we plan to moderate the pace of openings in the back half of 2022, with approximately 20 planned. Importantly, this has no impact on our ability to grow clinician count and revenue. This operating flexibility is one of the key areas we will continue to look at as we balance growth, profitability, and liquidity going forward.

In terms of M&A, we completed 4 new acquisitions in the second quarter, bringing the total since inception to 83. We remain on pace to deploy $50 to $70 million of capital for the full year against our M&A activities, and we continue to have a robust pipeline of acquisition opportunities.

As for tech-enabled services, our digital team is working to enhance our platform on multiple fronts to develop the best end-to-end experience for patients, clinicians and team members. We have now rolled out “OBIE,” our online booking and intake experience platform, to 9 states through the end of the second quarter, and have seen a substantial improvement in cancellation rates of online bookings in those markets, driven in part by better patient and clinician matching. We remain on track to roll OBIE out across the country throughout 2022 and into early 2023, with 5 additional states already completed in July.

Now, let me take a moment to discuss the key areas of learnings I’ve had in my new role as COO over the past few weeks, and how that is going to shape our go-forward action plans, as well as unlock future areas of opportunity.

As I met with our clinicians and operations team members, what is clear to me is that our teams have been focused on too many priorities, each competing for their attention.

To address this, we are aligning our teams on a focused set of narrow priorities that can drive the highest impact on the business: first, Net Clinician Growth, and second, Clinician Productivity. Both of these represent significant areas of additional upside opportunity as we look forward to 2023.

In terms of Net Clinicians, to accelerate the pace of growth, we are continuing to invest in our recruiting teams in the second half of 2022 which will give us organic hiring momentum going into 2023. This includes enhancing our teams with additional outbound-focused resources to increase our pipeline of candidates, further enhancements to our inbound funnel, and more focus from our operations teams on time allocated to interviewing.

Additionally, though retention has remained stabilized across the past year, we are investing in key areas of clinician satisfaction that we believe will drive incremental improvements to our retention numbers going into 2023.

For example, our clinicians have made it clear that we have two acute areas they want us to address immediately: first, patient billing customer service, and second, frontline team staffing. We have already begun addressing both by building out a call center dedicated to patient billing customer care and redeploying our planned practice operations investments to the frontlines: our front office coordinators and medical services teams.

We believe that investing in the further acceleration of our organic recruiting, and incremental improvements to our clinician retention, both represent upside to our current pace of net clinician adds as we go into 2023.

Turning to our second area of focus, Clinician Productivity. As we all know, there is no lack of patient demand in the market for mental health services. However, we believe there's still further opportunity to incrementally improve the conversion rate through every part of LifeStance's patient funnel via greater operational discipline. To deliver on this, we are taking the following actions:

First, at the top of the funnel, we are adding to our boots-on-the-ground primary care referral team through a redeployment of planned investments toward this initiative, as well as focusing on enhancing our internal referrals between our clinicians to ensure patients have access to the full suite of specialists at LifeStance.

Second, at the middle of the funnel, we are leveraging the capabilities of our digital team to improve patient matching via OBIE, enhance our overall provider profile systems to create a better user experience, and reduce the complexity of our scheduling system to open up hidden capacity. Additionally, our operations teams are focused on enhancing our phone intake customer care teams and reducing our credentialing timelines to drive better conversions and faster ramps.

Finally, at the bottom of the funnel, we have seen that our patient cancellation and no-show rates are running at approximately 15%. Though this number has been consistent for the past two years, we believe there is an opportunity to improve these rates further via digital enhancements to appointment reminders and the patient rebooking experience, and improved customer service and operational performance by our front office teams, with early signs of cancellation and no-show rate improvement in states where we are piloting action plans.

All of these top, middle, and bottom funnel areas represent further upside to clinician productivity as we look to the future, and we believe will give us strong momentum going into 2023.

With an enhanced focus on operational excellence, targeted at key areas of incremental opportunity, I am now, more than ever, excited about the future of our business. We will remain disciplined on our approach to driving improvements to our existing processes, as well as accelerating growth in net clinician adds and productivity. I am looking forward to providing updates in future quarters about the progress we make against these initiatives.

With that, I'll turn it over to Mike Bruff. Mike?

J. Michael Bruff, Chief Financial Officer

Thanks, Danish.

As usual, I will frame my comments in the context of our long-term strategy, which includes balancing growth, profitability, and liquidity considerations.

In terms of growth, the company delivered solid growth in the second quarter with revenue of $210 million, up 31% year over year, driven by growth in our clinician base.

Turning to profitability, in the second quarter, Center Margin of $60 million increased 17% over the same period last year, driven by strong revenue growth. Sequentially, Center Margin as a percentage of revenue expanded 187 basis points, primarily driven by timing of payroll taxes in the first quarter and expected operational expansion in the second quarter.

Adjusted EBITDA grew slightly year over year at $15 million, or 7.0% of revenue. Sequentially, Adjusted EBITDA as a percentage of revenue improved 84 basis points, driven by the improvement in Center Margin and operating expense discipline.

Turning to liquidity, LifeStance continues to be supported by a solid balance sheet. We exited the quarter with cash of $97 million and net long-term debt of $203 million.

In the second quarter, we generated positive $8 million of cash from operations, compared with $3 million in the first quarter.

Our free cash flow of negative $18 million improved by approximately $7 million quarter over quarter. We expect to continue to improve free cash flow in the back half of the year.

Operationally, we are continuing with planned investments to improve our days sales outstanding, which slightly increased by one day quarter over quarter.

After transitioning the Revenue Cycle Management team to report to me at the end of the first quarter, we hired a seasoned Chief Revenue Officer with a track record of delivering results in a scaling company. Our priorities include improving our billing and collections performance through scaling the team appropriately and driving productivity enhancements through process efficiency, technology and automation.

With cash on the balance sheet, access to our new credit facility, our focus on capital efficiency, and the underlying unit economics of our hybrid model, we feel that we are in a strong position to drive the long-term growth and value creation of the company.

Turning to guidance, Mike has already covered the full year.

As for the third quarter, we expect revenue of $216 to $221 million, Center Margin of $61 to $65 million, and adjusted EBITDA of $16 to $19 million.

With that, I'll turn it back to Mike Lester for a few words before going to Q&A.

Michael K. Lester, Chairman, President & CEO

Thanks, Mike.

I would like to recognize the continued efforts of our approximately 7,000 colleagues who remain focused on delivering high quality, affordable and accessible mental health care to our patients across the country.

Their unwavering dedication and support inspire all of us. On behalf of the team, I would like to extend my gratitude for all they do.

I am proud of what we achieved as a company to date, but there is so much opportunity in front of us.

Mike, Danish and I will now take your questions.

Operator?