LifeStance Third Quarter 2022 Earnings Script

Monica Prokocki, VP of Investor Relations

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

I'm Monica Prokocki, Vice President of Investor Relations. Joining me today are Ken Burdick, Chairman and Chief Executive Officer; Danish Qureshi, President and 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, business model and strategy.

Those statements involve risks, uncertainties, and other factors 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 helpful information for investors to 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?

Kenneth Burdick, Chairman & CEO

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

Over my four decades in healthcare, I have observed how we as a country have underfunded mental healthcare and underserved millions of individuals with both diagnosed and undiagnosed mental health conditions and I have witnessed firsthand the need for an integrated approach to physical and mental health treatment.

Informed by these experiences, I am thrilled to have joined LifeStance, a company with a Vision of a truly healthy society where mental and physical healthcare are unified to make lives better.

What the LifeStance team has accomplished over the past five years is extraordinary. From a standing start, they have built a uniquely positioned national business with over 5,400 clinicians and approximately $820 million in trailing-twelve-month revenue.

But some of the successful initiatives that brought LifeStance to where it is today must evolve for the company to grow to multiples of its current size, expand profitability and deliver on long-term value creation for patients, clinicians and shareholders.

I look forward to building on the successful trajectory set by the founders at a time when our services are needed more than ever.

Turning to financial results, we are lowering expectations for the year based on our third quarter performance and fourth quarter outlook.

Third quarter revenue was $218 million, on the low end of our expectations, primarily due to lower than expected visit volume. Center Margin of $60 million and Adjusted EBITDA of $15 million were primarily affected by revenue being on the low end of expectations as well as higher than expected costs associated with our employee health benefits program.

As for guidance, I'd like to share my perspective on how we intend to set financial expectations going forward. Our business, especially in this dynamic labor environment, produces some variation. As a service business, our revenue is driven by our number of visits, which is in turn driven by the number of clinicians, their capacity, and their schedule utilization. Danish will touch on each of these in detail. Recognizing this inherent variability in a relatively young company that is early in its journey, going forward we will present ranges reflective of this variability.

We are lowering our expectations for the remainder of the year. We now expect Revenue of $845 to $850 million, Center Margin of $229 to $232 million and Adjusted EBITDA of $50 to $53 million. These lower ranges are primarily due to lower than expected visit volume and the higher costs of our employee health benefits relative to our prior forecasts. Mike and Danish will provide additional color in their prepared remarks.

It is clear to me that we are not performing to our full potential. In taking on leadership of LifeStance, I am laser-focused on execution, profitability, and operational excellence. This will be our formula for long-term value creation.

Since joining the company in September, the leadership team and I have been working through our strategic planning process. We will provide an update on our multi-year targets and deliver guidance for 2023 during our fourth quarter earnings call.

Through these planning processes, as well as countless conversations with management, clinicians, and other team members from all across the company, I have some initial observations.

First, I believe that the business model and strategy are sound.

Therefore, we will continue to differentiate ourselves with our hybrid in-person and virtual care model, with a multi-disciplinary approach through which we can treat all types of mental health diagnoses.

We will also continue to expand access to mental healthcare through commercial in-network coverage, and primarily source our patients through referral partnerships with primary care providers.

And finally, we will continue to march toward our long-term vision of unifying mental and physical healthcare.

LifeStance succeeded in developing a unique business model that overcame historic industry challenges in the mental health space—developing relationships with commercial payors and increasing access to trusted, affordable, and personalized mental healthcare at scale.

There is no shortage of patients seeking the services we offer, and we believe that our ability to attract new clinicians to LifeStance remains unparalleled.

This company has the potential to become a unique and valuable component of the broader healthcare ecosystem.

Furthermore, our immediate priorities remain unchanged.

I am impressed with the quality of the people and their passion for our mission, and I believe we can deliver on our near-term goals as well as our long-term ambitions.

We have the right strategy, the right near-term priorities, and team; however, I also see opportunities to better position LifeStance to have the greatest positive impact on society while delivering superior long-term value.

LifeStance was founded in 2017, and the company has grown revenue at a compound annual growth rate of nearly 90% from 2018 through 2021. Like many growth companies, LifeStance has experienced natural growing pains as we have begun to outgrow certain processes and systems.

We need to evolve and build a platform that can meet the needs of a large, national business, that can scale to support LifeStance's full potential as the premier destination for clinicians and patients.

I have led companies with similar opportunities and challenges. These experiences have taught me that while it may not be easy and will not happen overnight, making the right investments and maintaining focus on the key priorities can establish the foundation for a long-term trajectory of growth and profitability.

We have a tremendous runway ahead of us—we've been in an all-out sprint. We now need to build processes and systems worthy of the huge opportunity before us.

Several areas will receive greater emphasis going forward.

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

Second, we will focus on simplifying administrative complexity and will make strategic investments in enterprise-level scalable infrastructure over the next few years—beginning in 2023.

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 and drive operating leverage.

For example, through the implementation of an enterprise workforce management solution, we expect to retire multiple systems and drive significant operational efficiencies while better supporting our clinicians and their patients.

Additionally, we will continue to make digital investments, such as a new virtual care platform, continued rollout of our online booking and intake experience, which we call OBIE, and launch new digital products to reinvent the entire patient care journey beginning with finding the right clinician and continuing through the entire treatment plan.

Third, our payor strategy will become more selective. Today we support hundreds of payor contracts. Streamlining our commercial payor contracts will reduce administrative burden and allow us to better align with payor partners who share our vision of expanding access to mental health care and improving the coordination between physical and mental health care. These partners *invest* in that vision with rates commensurate with the value that LifeStance clinicians provide.

Finally, we will continue our shift toward organic growth through expansion of our clinician recruiting team and a much more focused approach to M&A. Now that we've built a broad national presence, we plan to do fewer deals, aligned with some of the priorities I just referenced.

We will focus primarily on larger practices with a minimum clinician count, as each incremental acquisition adds administrative demands. We will further emphasize profitability and market density in the businesses that we acquire. And, we will ensure that new acquisitions bring in minimal exceptions when it comes to things like payor mix, service line adjacencies and operational processes and policies.

In summary, we're evolving from a purely growth mindset to creating a balanced set of objectives that include operational excellence, profitable growth, and disciplined capital deployment.

In closing, I am excited about what the future holds for LifeStance. Psychiatrists, nurse practitioners, psychologists, and therapists form the backbone of LifeStance. Whether we recruited them, or they joined us through acquisition, they make an extraordinary commitment to our patients. We will honor that commitment by providing them with the operational support and technology to optimize their ability to improve patients' lives. This is our calling at LifeStance.

2023 will be a year of transition for the company, with likely slower growth and a focus on investing in strategic initiatives that will build scalable infrastructure. I believe that these and other initiatives will set LifeStance up for long-term growth and profitability acceleration beyond 2023 while remaining disciplined with capital deployment.

With that, I'll turn it over to Mike to provide additional color on our financial performance and expectations. Mike?

J. Michael Bruff, Chief Financial Officer

Thanks, Ken.

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

Starting with growth. Revenue of $218 million was up 25% year over year driven by clinician growth of 24%.

Turning to profitability, Center Margin of $60 million increased 16% over the same period last year, driven by revenue growth, partially offset by growth in center occupancy costs.

Sequentially, we did not achieve the expansion that we anticipated in Center Margin as a percentage of revenue. This was driven by lower-than-expected revenue and higher-than-expected employee health benefits costs that impacted Center Margin in the quarter by $1.3 million, or 70 basis points. While our actuarial models for our self-insured program included assumptions for increased utilization during 2022, the actual magnitude of increase and the persistent inflationary environment have resulted in costs coming in higher than the models estimated last year.

Total G&A costs were in line with expectations and improved 95 basis points sequentially as a percentage of revenue.

Adjusted EBITDA grew 44% year-over-year to $15 million, or 7.1% of revenue, up 90 basis points, driven by Center Margin growth combined with generating leverage in G&A. Adjusted EBITDA was impacted by $1.7 million, or 95 basis points of higher health benefits costs relative to expectations.

Turning to liquidity, LifeStance continues to be supported by a solid balance sheet. We exited the quarter with cash of $90 million and net long-term debt of $212 million.

In the third quarter, we generated positive $6 million of cash from operations. Cash flow from operations was negatively impacted by an increase in accounts receivable resulting in a 4.5 day increase in DSO sequentially. The increase in DSO was primarily driven by approximately 3 days of payor-specific items. For example, we had some holds and short pays related to the implementation of rate increases and new coding requirements, which we expect to be substantially resolved in the fourth quarter. We are continuing with planned investments to standardize and optimize our billing and collections processes. Over time, these initiatives will drive improvement in cash collections efficiency.

Our free cash flow of negative $9 million improved by $9 million sequentially, primarily driven by lower capital expenditures from the planned moderation of de novo center openings.

Turning to Guidance, Ken covered our full year expectations. For the fourth quarter, we expect Revenue of $215 to $220 million, Center Margin of $55 to $58 million, and Adjusted EBITDA of $7.5 to $10.5 million.

Revenue is below prior expectations due primarily to lower forecasted visit volume. Fourth quarter Center Margin and Adjusted EBITDA are below prior expectations due to lower Revenue as well as the higher than expected costs associated with our employee health benefits, representing $3.3 million of impact to Adjusted EBITDA, or 170 basis points, of which $2.6 million will impact Center Margin, or 135 basis points.

Now, I'll turn it over to Danish to provide additional operational color.

Danish Qureshi, COO

Thank you, Mike.

Regarding financial performance, let me be clear that I am disappointed with our third-quarter results and full-year expectations.

The company has been in hyper-growth mode for the past five years, and we are now taking the time to more closely examine the underlying drivers of our performance to ensure that we are maximizing long-term value creation.

Despite being a co-founder, since stepping into the COO role, my understanding of our practice operations has evolved significantly in the last quarter. We have insights into the business now that we didn't have four months ago—and the team and I will continue to work exhaustively to dig deeper and ensure that we have the right data, KPIs and predictive capabilities to drive the business.

Like Ken, I feel that we are not yet delivering on our full potential. However, I am confident that with a greater focus on execution and operational excellence, as well as strong leadership and the commitment of our dedicated team members across the organization, we will be better positioned to drive long-term value.

With that, let me provide an update on the various areas of operational improvement we discussed on our last earnings call.

My first order of business as COO was to align our teams on a focused set of narrow priorities that can drive the highest impact: first, Net Clinician Growth, and second, Clinician Productivity. As Ken said, these priorities remain unchanged.

In terms of Net Clinicians, we grew our clinician base to 5,431 with the addition of 205 net clinicians, relatively in-line with prior quarters. Importantly, this growth was driven by sequential improvements in organic starts and retention, partially offset by an intentional moderation of acquired clinicians via M&A activities.

Regarding organic starts, we continued to invest in our recruiting teams in the third quarter. Year-to-date, approximately 80% of our gross clinician adds were organic rather than acquired, and we will continue to further invest in our teams in the fourth quarter to give us hiring momentum going into 2023.

Regarding retention, we saw a small improvement driven by our previously stated initiatives around frontline staffing enhancements and patient billing customer service, as well as beginning to infuse the mantra of “wrapping our clinicians with support” into the culture of everything we do here at LifeStance. Though encouraging, it is too early and the relative improvements too small to change our previously stated planning assumption of approximately 80% quarterly annualized retention.

Regarding acquired clinicians, we completed 3 acquisitions in the quarter. As previously stated, we are intentionally moderating M&A as we continue our shift toward organic growth. The sequential clinician gains this quarter from organic starts and retention were offset by fewer adds via M&A. Though we may see fluctuations in this trend as the timing of acquisitions can be lumpy, we will continue to direct greater effort toward growth via recruiting and incremental improvements to clinician retention as the primary drivers of Net Clinician Adds.

Turning to our second area of focus, Clinician Productivity. This call, I wanted to go deeper into explaining how we now think about productivity at LifeStance.

Clinician productivity is driven by a combination of two things: one, the time clinicians make available to see patients (what we internally refer to as capacity) and two, our ability to fill that time appropriately with patients (what we internally refer to as utilization).

While we are seeing early indications of improvement in utilization, driven by the top, middle, and bottom funnel actions I spoke about on our last call, those gains were offset by a decrease in capacity from clinicians as they continued to take elevated levels of time off in the third quarter versus prior periods.

Let me first touch on utilization and provide an update on the actions we have taken to drive greater operational discipline and impact the productivity levers most directly within our control.

First, at the top of the funnel, in terms of attracting new patients, we did four things: (1) built out our boots-on-the-ground primary care referral team, (2) made enhancements to our organic search traffic, (3) focused on improving internal referrals between our clinicians, and (4) began conversations with enterprise referral partners about potential multi-state collaborations. These actions delivered improvement sequentially at the top of the funnel.

Second, at the middle of the funnel, in terms of converting patients to scheduled appointments, we did four things:

(1) We leveraged the capabilities of our digital team to improve patient matching via OBIE, which is now live in 14 states and will be fully rolled out nationwide by the end of Q2 2023, with patients rating the booking experience an average of 4.4 out of 5, year-to-date.

(2) We enhanced our overall provider profile systems to create a better user experience (a project we call "ConnectMe"). We launched the ConnectMe pilot in September, and quickly pivoted to a nationwide rollout in October, with a planned completion date of December 31st.

(3) We reduced the complexity of our scheduling system to open up hidden capacity, and

(4) We improved our phone intake answer rates and reduced our credentialing timelines to drive faster ramps.

These middle funnel actions were slower to take hold in the third quarter, but recent data indicates they are beginning to gain traction and should have a more meaningful impact in 2023.

Finally, at the bottom of the funnel, in terms of scheduled appointments converting to completed visits, our patient cancellation and no-show rates were running at approximately 15%. In the quarter, we drove a small but meaningful improvement in this rate to 14% by putting a focused spotlight on this KPI across all operational teams. Based on these early results, we have put together a new taskforce to drive further acceleration of improvements in this area, with a goal of having an impact in 2023.

Through these top, middle, and bottom funnel efforts to better fill clinician schedules, we have seen overall utilization tick slightly higher in the third quarter.

It is still early days for these initiatives, and because of that, we have not assumed any incremental improvements to productivity from utilization as part of our Q4 guidance.

Turning to capacity, in the third quarter we found that, on average, clinicians made less time available for patient visits than in the second quarter.

As previously discussed on our Q2 earnings call, clinicians increased their time off in June and we carried those planning assumptions forward into the remaining summer months of July and August. Though clinician time off in September declined compared with the summer months, it did continue to run at slightly elevated levels relative to the first half of 2022 and versus the prior year comparable period.

This summer, we conducted a detailed survey across our thousands of clinicians to better understand their preferences. This "Future of Work" study revealed that clinicians value the flexibility we offer, and that on average, they may want to work slightly less over time. We recognize that this labor dynamic is potentially not just a short-term, post-Covid issue. The desire for flexible work and flexible schedules is consistent across many industries, and LifeStance's value proposition was purposely built to support a range of clinician work preferences.

It is still too early to confirm whether slightly lower capacity will persist, and for now we are rolling forward into the fourth quarter the productivity trends we observed in the third quarter, which is the key factor driving down our revenue expectations for the near term. Longer term, we will focus on strategic actions to meet clinicians where they are and provide clinicians who would like to work fewer hours or take more time off with part-time options that appeal to them but are still financially sound for the business.

In closing, as we continue to learn more and gain deeper insights, my confidence in our ability to execute has never been stronger. Operationally, we will focus on the key priorities within our control, such as organic clinician growth and optimizing clinician utilization through our top, middle and bottom of funnel actions, as well as taking a more focused approach to M&A and payor partnerships. We expect these efforts to get us to higher levels of revenue and profitability over the long-term.

In terms of leadership, I want to note that we are also enhancing our teams by recruiting top talent. For example, we welcomed Lisa Miller in September as Senior Vice President for the North Division. Lisa has a strong track record of operational excellence in healthcare services, having most recently served as COO for Invo Healthcare and Division Vice President at DaVita.

I am now, more than ever, excited about the future of LifeStance and look forward to driving operational improvements across the business.

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

Kenneth Burdick, Chairman, President & CEO

Thanks, Danish.

I would like to comment on the announcement we made last week. Aligned with our objectives of building long-term scalable infrastructure, we are establishing a Business Transformation Office dedicated to end-to-end process optimization, standardization and automation.

Mike Bruff will take on a new role as Business Transformation Officer leading this initiative. I would like to thank Mike for his contributions as CFO and building a stronger finance organization, demonstrating strategic company leadership and leading with integrity.

I would also like to welcome to the team Dave Bourdon, who is succeeding Mike as CFO. Dave has extensive knowledge of the healthcare and behavioral health industries and two decades of experience leading finance organizations, including as CFO of a $45 billion business unit at Cigna as well as CFO of Magellan Health. I have the utmost confidence in his ability to take over the reins of our talented finance organization.

In closing, I am so inspired by the great work taking place every day by our clinicians and team members to expand access to high-quality, affordable and personalized mental healthcare, and feel confident that we are putting the right actions in place to drive long-term value.

Mike, Danish and I will now take your questions.

Operator?