VieMed
Third Quarter 2024 Earnings Call
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<u>Presenters</u>
Todd Zehnder - COO & Director
Casey Hoyt - CEO & Director

<u>Q&A Participants</u>
Brooks O'Neil - Lake Street Capital Markets
Doug Cooper - Beacon Securities
Ilya Zubkov - Freedom Broker

Operator
Greetings, and welcome to VieMed's Third Quarter 2024 Earnings Conference Call. At this time, all participants are in a listen only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, you can press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Todd Zehnder, COO. Thank you. You may begin.

Todd Zehnder
All right. Thank you, Rob. Good morning, everyone. We appreciate you joining us today. Please note that our remarks in this conference call may include forward-looking statements under the U.S. federal securities laws or forward-looking information under applicable Canadian securities legislation, which we collectively refer to as forward-looking statements. Such statements reflect the company's current views and intentions with respect to future results or events and are subject to certain risks and uncertainties, which could cause the actual results or events to vary from those indicated in forward-looking statements. Examples of such risks and uncertainties are discussed in our disclosure documents filed with the SEC or the security regulatory authorities in certain provinces of Canada. Because of these risks and uncertainties, investors should not place undue reliance on forward-looking statements.

The forward-looking statements made in this conference call are made as of today, and the company undertakes no obligations to update or revise any forward-looking statements, except as required by law.

The third quarter financial news release, including the related financial statements, are available on the SEC's website.

I'll now turn it over to VieMed's CEO, Casey Hoyt, to get things started.

Casey Hoyt
Okay. Thank you, Todd, and good morning, everyone. We appreciate you joining us today. The third quarter results exceeded both our projections and expectations, driven by continued organic growth in our core businesses as well as continued growth from recent M&A activity, leading to strong year-over-year and sequential growth in net revenue.

Our third quarter net revenue established yet another company record of $58 million, exceeding the top end of our guidance and establishing a pathway to a strong finish in 2024.

I want to acknowledge and thank our incredible VieMed family, which now numbers more than 1,150 employees. Their dedication to our Live Your Life mission and their relentless focus on patient satisfaction and operational performance will enable a strong finish to 2024.

You've heard us talk about earning the trusted place in the home for some time. I want to drill down on that a bit more this morning and why it matters. VieMed is substantially differentiated from HME providers to the point that we believe that even the description home medical equipment doesn't fully capture exactly what we're doing in the home and the value we're proving out every day to patients, providers and payers. It's clear that there is a trend of providing clinical care in the home. Patients want to be treated in the comfort and safety of their home, hospitals and health systems want to avoid readmissions, and payers know that the costs are lower in the home versus an institutional setting.

Improving outcomes, patient satisfaction and operational efficiency are the pillars for delivering care in the home. VieMed has been a leader since day one with our high-touch, high-technology care model.

What's become clear to us is that, in today's environment, patient satisfaction is more critical than ever. A focus on patient outcomes and personalized care, not to mention offering support to address patient concerns, becomes increasingly important, particularly when it comes to patient compliance. Utilizing advanced tools, such as our proprietary

Engage platform, can boost provider communication and care coordination. These solutions need to be scalable to streamline operations and provide the accurate data ultimately needed for value-based care.

This isn't a future state we're talking about at VieMed. This is the model that we have been deploying with our RTEs at the center of everything we do in the home. It's the reason why we've allocated capital investments in technology, recruiting, training and the provision of social services we offer to our patients. We're ready for where the industry should be going, and we expect to continue to lead it.

On the regulatory front, we're seeing some positive signs of support for the industry. VieMed has been a leading advocate for the reconsideration of NCD 280.1, emphasizing objective and comprehensive coverage policies for NIV therapy.

We believe that the request for the NCD is another signal we've seen from CMS that they are serious about holding MA plans accountable for appropriate guidelines to deliver clinical care. The majority of comments submitted on the NCD have been positive, and we think this is a real opportunity for the industry to serve those in need and facilitate continued expansion. The reason we've been proactive on the NCD is that establishing clear and consistent guidelines will create a stable business environment for providers and reduce uncertainty for patients.

The research supports the efficacy of the NIV, resulting in significant reductions in costs, hospitalizations and improved patient outcomes. And the data exhibits there is medical necessity for putting patients on the device immediately and improving their quality of life.

We've submitted our comments on the NCD and have sponsored or supported much of the research cited in other comments. We'll continue to provide a leadership role through VieMed and through the industry trade associations.

I'd also like to highlight that there has been some recent movement on the 75-25 reimbursement relief. Recall that this rate adjustment for certain products in certain areas would increase Medicare reimbursements for providers serving those areas. This isn't dead by any means. It adds positive momentum with some recent legislative support, and it should be backed up for consideration at the end of the year. As we've noted before, restoration of this relief would be positive for the financial performance in 2025.

Let me now turn to some brief updates on the business. The continued strength of our vent business was on display again this quarter with a 4.3% sequential increase in active vent patients. That sequential growth is usually a leading indicator for future quarters and reinforces the positive outlook we have on the business. The 400-plus increase in vent patients we've experienced in both Q2 and Q3 is as good as we've produced in a number of years.

One of the reasons our vent growth has been so strong is the operational overhaul we completed earlier in the year. Those efforts resulted in internal processes driving higher vent utilization and vent patient billings.

The new sales structure we put in place and discussed last quarter is having an impact, as well. With an 18% increase in average monthly setups per sales rep compared with what they were producing prior to the implementation, we've been accelerating the recruitment of sales reps to maintain our industry-leading organic growth. We expect to have more to report on this effort in Q4.

In our sleep business, all I can say is what a difference a quarter makes in terms of the overall narrative around GLP-1 drugs. Based on what we've seen from ResMed and others so far, we believe it's pretty conclusive that GLP-1s are not impeding the growth of the sleep business. As we noted before, in fact, it appears to be bringing more patients into treatment for sleep apnea and other disorders as they lose weight.

Despite the increasing use of GLP-1 therapies for weight loss, both obesity and sleep apnea rates continue to climb. For patients with moderate to severe obesity-related sleep apnea, research consistently shows that combining PAP therapy with weight loss provides greater benefits than either treatment alone.

Real-world data reveals that OSA patients prescribed GLP-1 medications are 10.8% more likely to start PAP therapy with significantly higher adherence rates, evidenced by increased PAP resupply orders at one and two years post setup.

The improvement in sentiment and the increasing amount of published research lines up with what we're seeing in our business. We're seeing sequential growth in CPAP units, patients, resupply orders and home sleep tests. Even though sleep is currently contributing 17% of our total revenue as of Q3, we believe we've only scratched the surface of what this business can contribute to our overall growth.

We're still on track with our East Alabama joint venture integration plans. We've made incremental progress each of the last two quarters, and as this is our test case for future JVs like this, we are easing our way into our growth plans. We outlined a plan for annualized revenue of approximately $4 million when we made this acquisition, and that's the path we're on. We expect to have more to report out on the JV at the year-end.

Our M&A pipeline remains robust with a focus on adding complementary services that could expand our core businesses. These new opportunities could also build on the strong relationships we've already earned with patients and could enhance our value to providers and payers through greater scale and efficiencies. Overall, I'm pleased with how we've executed throughout this quarter. We've regularly challenged our team to hit our strategic goals, and they've delivered.

With record-breaking quarters in 2024 on top of our highest EBITDA quarter ever in Q3, we have built up a lot of positive momentum for the fourth quarter that will feed into 2025.

The increasing vent patient and sleep patient growth, together with our sleep resupply business, provide a strong base of organic growth. We have no intention of letting up. We are laser-focused internally on finishing on a strong note, which will provide the exit velocity for a stronger year in 2025.

For more on our operational and financial results for the quarter, I'll turn the call back over to Todd.

Todd Zehnder
All right. Thanks, Casey. In reviewing the financial results, all figures are in U.S. dollars, and the full results have been made available on the SEC website. I'll focus my prepared comments on providing some additional color behind our strong performance. You'll notice we added some new disclosures this quarter around our sleep therapy patient count and sleep resupply orders. Based on feedback we've received from the investment community, we've been exploring some incremental disclosures that can assist in measuring our performance. Our goal is to build on these disclosures over the next couple of quarters.

The new company record for revenue this quarter and the 17% increase was driven almost entirely by organic growth with inorganic or acquired revenue accounting for $1.1 million of that year-over-year increase. Our revenue increased 6% on a sequential basis with inorganic or acquired revenue accounting for only $327,000.

The organic growth story at VieMed is alive and well, and in our mind, provides a high level of predictability of growth in a very capital-efficient manner.

Our core business in vents accounted for 55% of the revenue this quarter with sleep increasing to 17%. Our oxygen and staffing businesses continue to grow, as well, with those each contributing roughly 10% of this quarter's revenue. We're also making incremental improvements with the East Alabama Medical Center JV.

Gross margin was fairly consistent with the last two quarters at 59.3%. Recall, that's down year-over-year due to a change in product and service mix as sleep, oxygen and staffing continue to grow at a faster rate. Slightly above and below the 60% mark is where this current business mix should be.

The EBITDA margin for the quarter was 24.1%, which is up from 23.3% in the second quarter and compares favorably with 24.5% a year ago. We've made substantial improvement each quarter, and we're aiming for another strong performance in the fourth quarter.

We've done a really good job of managing SG&A with these expenses down to 46% of revenue this quarter compared with 48% in the second quarter and 48% a year ago. We are investing in new sales talent, improving -- and improving our patient experience in the home.

The continued reduction in SG&A as a percentage of revenue is a reflection of good cost controls, but also the leverage we're getting from better productivity and efficiencies from operational and process improvements that have been put in place.

As expected, our gross CapEx this quarter was higher than normal, driven by our strategic acceleration of the vent exchange initiative. For the quarter, we invested approximately $11 million on CapEx, primarily on various respiratory equipment for our patients. Offsetting these purchases was approximately $6 million of related sales and exchange proceeds, putting our net cash CapEx for the quarter at approximately $5 million.

We expect to sell more vents over the next several quarters, but the pace and amount will be determined by the remediation process established by Philips and the related governmental agencies.

We have once again funded our CapEx out of discretionary cash flow and continue to manage the business in order to drop free cash flow onto the balance sheet. Our percentage of net CapEx to EBITDA was at 36% this quarter compared with 64% in the second quarter and 58% a year ago. We will continue to update our free cash flow disclosure on an annual basis.

Similar to last quarter, we recorded a small gain of $0.5 million that was primarily driven by the Trilogy return program. We would expect to continue reporting these gains until the project is completed, likely next year.

The balance sheet remains in great shape as we paid down our line of credit by $2 million during the quarter, giving us $55 million available on our credit facilities along with a $30 million accordion if needed for an attractive use of proceeds. We built up cash by $2.5 million to $11.3 million as of quarter end and improved working capital to $11.3 million.

The tremendous opportunity we have to upgrade our vent fleet through the Philips buyback is enabling us to prioritize investing in our organic growth. The increased liquidity also gives us the flexibility to consider additional M&A in the future that can be complementary to our growth.

The momentum in the business is demonstrated in our outlook for the fourth quarter. We are anticipating net revenue in the range of $59.7 million to $60.9 million. The midpoint of that range implies sequential growth of 4.0% and a year-over-year increase of 18.9%. This outlook is based on sequential growth in vent patients, continued contribution from our sleep business, along with anticipated growth in our other products.

There aren't too many moving parts for us coming into the fourth quarter. Without assuming any material diversion from the margin profile we've experienced most of this year and the typical liquidity ramp we see during the fourth quarter, we believe it's realistic to expect a solid adjusted EBITDA finish to the year, as well.

With the improvement we've made every quarter this year from operational and sales efficiencies, driving organic growth, self-funding CapEx through cash flow and improving the balance sheet, it's critical to maintain that momentum and operational excellence during the fourth quarter. We're confident that we will, which should position us very well for a good year in 2025.

Thank you for joining us today. This concludes our prepared remarks. We will now open the floor up for questions.

Operator
Thank you. At this time, we’ll be conducting a question and answer session. If you’d like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you’d like to remove your question from the queue. For participants using speaker equipment, it may

be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Our first question comes from Brooks O'Neil with Lake Street Capital Markets. Please proceed with your question.

Brooks O'Neil
Thank you very much, and good morning, guys. Congratulations on the terrific progress you're making. To be honest, (inaudible) you guys provided such a great overview, I only have one significant question, and I probably should know the answer to this before I even ask it. But, Casey provided a nice overview of the positive shift in the regulatory environment. I'm curious if what they're talking about involves any increased reimbursement, or maybe I should say any change in reimbursement, or is it just clarifying some of the usage guidelines and whatnot? Thank you.

Casey Hoyt
No problem. There's two regulatory -- not issues, but things that I commented on. 75-25 is a rate relief reimbursement fluctuation. Brooks, I'm not sure if you recall, but back during COVID, we got rate relief, and what they did at the beginning of last year is they recalled that relief. And so the 75-25 movement was a rural demographic mix split that they were going back and looking at the areas that we received relief and seeing if we could get that recalled basically. That's not dead. There's a lot of movement behind it. It's about $140 million lift for CMS to recall that, which is not that big. We represent less than 2% of the CMS Medicare spend as an industry.

So we got some legislative support behind us, and we'll be hopeful at the end of the year to maybe recover that. But that would just be a net win for us.

The other is the NCD comment. That's no relation to any kind of reimbursement shift, but it's just good policy to develop clear clinical guidelines. CMS is kind of acknowledging that they're a little too vague right now, and it's allowing MA to make up their own rules, for lack of a better description

And so they're honing in on that to where MA follows their clinical guidelines. And in order to do that, they’ve got to go into a comment period and ask for all comments, which there was no better time to have all of the research buttoned up that we've invested into over the last five to seven years to be able to kind of comment through the lens of data and publish research and rather than our opinion as a vent provider. It was extremely powerful, and we saw a lot of our peers and industry associations follow suit to our comments and latch on to them, as well.

So the industry was reasonably aligned with all of their commentary as it related to this, so CMS should have some powerful data to write some clear guidelines here in the future, which would be a major win for our entire industry.

Brooks O'Neil
Great. Fantastic. Congratulations again on the terrific progress.

Casey Hoyt
Thanks, Brooks.

Todd Zehnder
Thanks, Brooks.

Operator
As a reminder, if you'd like to ask a question, please press star, one on your telephone keypad. One moment while we poll for questions.

Our next question comes from Doug Cooper with Beacon Securities. Please proceed with your question.

Doug Cooper
Hey, good afternoon, guys. Nice quarter. Todd, I just wanted to focus in on the -- I guess, the increased disclosure around the sleep business. I just want to make sure I got -- I understand the disclosure here. So I guess it's the fourth bullet point in your press release, the company increased its sleep therapy patient count by 11% sequentially to 19,478. And then the company also increased its resupply orders by 9.7% sequentially to 22,143. So there's, let's call it just round figures, 20,000 patients in your sleep program today. And then -- but there's 22,000 -- it looks almost like there's more people in the resupply program than you have actual patients. How should I read that?

Todd Zehnder
Those are mutually exclusive, Doug. So the sleep therapy patients are the ones that are on PAP -- like we're actually renting them the machine right now. The resupply (inaudible) developed over the last, call it, five to ten years. And so they're no longer in their generally, what, 13-month cap period, and so they're just on resupply. So you should add those together effectively to get to what -- the patients that we serve during the quarter, which was roughly 42,000.

Doug Cooper

42,000. Okay. And then so the resupply order, that's 22,000 -- is that three times a year--

Todd Zehnder
--It depends. I think on average, we're a little -- we're probably closer to two, two and a half times per year. It depends on insurance companies, and it just depends on patient preference on how often they reorder. But ours is between two and two and a half as a total company.

Doug Cooper
Okay. And just on -- when I relate it back to your financials, I see the line item other durable medical equipment rentals of $12.5 million. That's directly related to the 42,000 patients.

Todd Zehnder
That would have the 22,000 patients -- or excuse me -- the 20,000 patients that are renting the machine. The resupply would be service revenue. But additionally, on that -- the other rentals, you would have your oxygen patients, everything else, vests, nebulizers any -- just the whole continuum of products.

Doug Cooper
Okay. And then, finally, just the other equipment sales, that would be the resupply program, the $8.4 million?

Todd Zehnder
Yes.

Doug Cooper
Is there anything else in that number other than the resupply program, or is that predominant--

Todd Zehnder
--It's primarily resupply, but there is other things in there.

Doug Cooper
Okay. Okay. And then to your point, Casey, the 469 patients you added on the vent program, I think I went back and looked -- this might be -- in fact, it might be the biggest lift I've seen on an absolute basis. Maybe -- well, I went back five years. There might have been one quarter where you added more than that, and there was 455 in the -- in quarter

two. What do you attribute to -- is it just increased sales, or are the referring docs are they becoming more comfortable with the program?

Casey Hoyt
I mean, I really attribute it to our training program, our restructure of the sales force. It's -- we're doing more with less. And these guys are extremely productive. They're polished. They're more educated. We have the right people in the right spots throughout the country. It wasn't an easy movement. We moved 12 folks into upper -- middle management and just restructured the entire sales force.

I would say that we still -- and we started talking about this at the beginning of the year, but we've yet to really benefit from the recruiting, the localized recruiting benefits that are on the ground just because we've been so laser-focused on training our folks up.

But that's the next phase of the sales restructure is really recruiting people localized in their backyards. And we have the recipe now for training. We have the recipe right now for finding the right people. Now it's 2024, and -- I mean, Q4 and 2025 is going to be about recruiting and finding these guys and incrementally growing. So we're super excited about where we sit right now.

Doug Cooper
Okay. And just finally, on the M&A side, you said it's -- the pipeline is looking pretty robust. Any color on what -- is it in the sleep? I'm assuming it wouldn't be vents, but would it be sleep? Would it be outside of the respiratory space? Maybe just more color on kind of size of the companies you might be looking at?

Todd Zehnder
We're not always going to be leaning towards respiratory, Doug. We're not exclusive to that. I mean, we will look at other businesses. We've looked at other businesses. We generally have said that the size of the HMP acquisition, which is a really good size, which was that $25 million to $30 million range. But we'll do smaller deals as necessary, or we'll look at larger deals. So we've got a little bit of everything in there right now, but it just feels like we're getting more inbound calls over the last, call it, three months than we had the prior couple of years.

Doug Cooper
Right, right. Okay, that’s it for me, guys. Terrific work.

Todd Zehnder
All right, Doug, thanks.

Casey Hoyt
Thank you.

Operator
Our next question is from Ilya Zubkov with Freedom Broker. Please proceed with your question.

Ilya Zubkov
Yeah, good afternoon, and thank you for taking my questions. So my first question is on the EBITDA margin expansion. I see that adjusted EBITDA margin is expanding from quarter-to-quarter this year, and I was wondering if the primary driver for that is permanent like economy of scale? And if yes, could it be in effect next year, as well?

Todd Zehnder
Yeah. I mean, generally, our EBITDA margins do get stronger as the year goes on. If you look at it just quarter-over-quarter, we generally see higher margins. But the answer is yes, we do see some efficiencies that have come with scale. The reduction year-over-year is just due to the revenue composition. As vents become a slightly smaller percentage of our revenue, it's a challenge to keep our margins flat, but we were pretty close with that, and that just shows that everything across the board is getting a little bit more efficient with scale and we get the leverage of becoming a bigger company.

So a lot of moving parts and pieces, but we're extremely excited about the overall metric. That's why, in my prepared remarks, I talked about revenue as a percentage -- or excuse me -- SG&A as a percentage of revenue. Because the gross margin is very product driven, the G&A is something that we have more control over and the scalability that you're referring to.

Ilya Zubkov
Great. Thank you. And another one on the current progress in replacement of recalled ventilators - so I see that CapEx is growing, and I wanted to ask if you expect further increase in CapEx in nearest quarters, and what is the expected timing for full -- replacement of recalled ventilators?

Todd Zehnder
Yes. I mean, like I said in the earlier part, we definitely saw an increase this quarter, but we're starting to measure it on a net CapEx because the third quarter was where we really got into a groove of selling -- or distributing our vents back to Philips. And obviously, our vent patient count is growing, so we have to replace those vents with CapEx. It's why you

saw us very deliberately disclose net CapEx, and we're very proud that I think the net CapEx as a percentage of EBITDA is probably the lowest it's ever been in our corporate history.

I would expect that number to continue to be very large this quarter. And very likely, it will stay like that through at least the middle of next year. We're kind of waiting on Philips and the FDA and anybody else that is going to be needed to make a decision of when they can actually remediate some of their vents versus us just selling them back to them. But we'll be working in conjunction with them to see how that all shakes out to determine whether we keep selling at the rate that we are right now or maybe we send some back to be able to stay on patients and so forth.

So it's a little early for us to say how long it will take us to finish, but it will definitely go into next year because we still have a pretty significant fleet out there.

Ilya Zubkov
All right. Thank you very much.

Todd Zehnder
Thank you.

Operator
We have reached the end of the question-and-answer session. I'd now like to turn the call back over to management for closing comments.

Todd Zehnder
All right, we want to thank everybody for listening in. And if you have follow-up questions, please reach out to us, and we look forward to talking to everyone. Have a great day.

Operator
This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.