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CONFERENCE CALL PARTICIPANTS

Anna Kruszenski

Jack Senft

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Talkspace Second Quarter First Half 2022 Earnings Conference Call. (Operator Instructions) Thank you.

Mike Lovell, Senior Director, Investor Relations, you may begin your conference.

Michael Lovell - *Talkspace, Inc. - Senior Director of IR*

Good evening, everyone. Thanks for joining Talkspace's 2022 Second Quarter Earnings Call. I hope you've had the opportunity to access the press release. We posted on Talkspace's IR website, a presentation of our earnings results. We'll use the presentation to walk you through today's remarks. We will begin with comments from Chairman and Interim Chief Executive Officer, Doug Braunstein, followed by Chief Financial Officer, Jennifer Fulk. Both are available for questions following their prepared remarks.

Certain measures we'll discuss on this call are expressed on a non-GAAP basis and have been adjusted to exclude the impact of one-off items. Reconciliations of these non-GAAP measures are included in our earnings release and on our website, talkspace.com. I also want to remind you that we will be discussing forward-looking information today, which may include forecasts, targets and other statements regarding our plans, goals, strategic priorities and anticipated financial results. While these statements represent our best current judgment about future results and performance as of today, our actual results are subject to many risks and uncertainties that could cause actual results to differ materially from what we expect.

Important factors that may affect our future results are described in our most recent SEC reports and today's earnings press release. For more information, please review our safe harbor disclaimer on Slide 2.

And now I'll turn the call over to Doug, who will begin on Slide 3.

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

Thanks, Mike, and thanks for all of you for joining us today to discuss our second quarter results. I'm going to start with a summary of our second quarter financial performance on Page 3, and then I'll provide you an update on the progress we've been making on our strategic priorities. We continue to see solid demand for our services, and we're pleased with our performance in the second quarter, particularly against the backdrop of a more challenging macro environment.

Revenue for the second quarter was down 4% year-over-year and essentially flat quarter-on-quarter, driven by an expected decline in B2C revenue mostly offset by strong growth in B2B. As I noted last quarter, we continue to experience sustained momentum in our B2B business, which was up

47% year-on-year reflecting a meaningful increase in the number of sessions, active members, number of accounts and employees served in our DTE business.

We instituted a number of changes to our B2B product during the second quarter, and those had some negative short-term impact on the sessions completed for the period, and that contributed to a slower growth quarter-on-quarter for our payer-related businesses. As others have noted, the macro environments also impacted the selling cycle in our DTE business with many larger accounts deferring additional benefits until January. While growth in that business was quite positive quarter-on-quarter, we expect growth may slow given tightening spending parameters for some of our DTE customers.

As you know, we're also very focused on optimizing returns in B2C. In line with prior quarters, we continued to reduce our marketing spend, and we also implemented a number of product enhancements that led to declining consumer acquisition costs for the second consecutive quarter. Year-to-date, our actions continue to be accretive to our unit economics. And importantly, despite a meaningful reduction in advertising costs, our organic traffic increased sequentially, which I believe is a testament to the strength of our brand, which is one of our long-term strategic assets.

So if you turn to Slide 4. Since January, we've consistently communicated our focus on a number of strategic priorities that we believe will improve performance over time. We've made meaningful progress across each of these initiatives. And as we move forward, we further focus these priorities into the following strategic areas of opportunity that I want to speak at a little more length today. These are continuing to invest and grow our B2B business, continuing to optimize our B2C business, making Talkspace a platform of choice for our professional network and achieving breakeven profitability through disciplined capital deployment.

With that, let me dive into our progress on each of these initiatives. First, our focus remains on growing our B2B business. In fact, changes we made through our unified funnel in the second quarter have begun to demonstrate significant leverage for our consumer brand to drive B2B member growth. We now estimate that several thousand additional B2B members join our platform each month via our consumer website. As a result, the total number of active members on Talkspace platform increased by 7% in the second quarter from the first as growth in B2B users outpaced B2C member declines.

Importantly, we believe that our managed behavioral health cohorts are sticky. Thus, monthly utilization improves as cohorts mature. To continuing to increase the B2B funnel inflow will ultimately build our B2B user base over time and improve the platform's overall unit economics. Moreover, we don't recognize this conversion funnel from B2B membership in our calculations for B2C, meaning that conversion and LTV from the B2B members is not included in our consumer marketing calculations.

We also introduced new session modality in our B2B business in the second quarter for our customers. This product change was important to our payers and it's designed to improve the B2B member journey. As expected, these changes initially reduced volumes in the second quarter, but now these improvements are driving increased customer conversion satisfaction and we believe revenue growth heading into the third quarter. We continue to improve the B2B platform experience for our members and therapists, and we expect to drive more engagement with ongoing product enhancements released during the back half of the year. We remain in active discussions to increase our covered lives with existing large national payers.

For a number of these accounts, while lead time and network connectivity creates uncertainty around the specific launch timings, we do expect to have meaningful additional lives added during the second half of 2022. Our DTE business grew nicely in the second quarter, including the launch with a major national retailer as employers continue expanding mental health benefits for their employees. We continue to invest in marketing, in prospecting and pipeline management tools all to drive stronger sales as we increasingly target our larger opportunities. We also implemented pricing changes designed to enhance margin over time.

Throughout the quarter, we added logos on a gross and a net basis. However, we have begun to notice longer lead times for converting these larger accounts and increased discussions related to more cost-effective capabilities. As such, we began to test market our Talkspace self-guided product at the end of Q2. While it's very early days, initial efforts have been quite encouraging, and we expect this product to be an important component of our DTE sales efforts going forward into '23 as we ramp up our marketing efforts around the product.

Turning to our work optimizing our B2C business. We continue to focus on improving unit economics in a variety of ways. We've worked to optimize our spend, increase organic content, improved conversion rate, potential customers, facilitate out-of-network bill submissions and work to increase retention. While not all of these efforts have been needle moving, it's worth noting that in aggregate, we have delivered on a large improvement in efficiency in the past 2 quarters. Media spend is down nearly 50% sequentially in the last 3 quarters, while revenue was down 18% on a reported basis and down 13% on an adjusted basis.

We enjoyed declining CACs for 2 consecutive quarters, reversing a 6-quarter trend and average revenue per user continues to rise slightly as well as consumers choose our higher-tiered subscription products. Of course, we remain cautious in the current environment as media costs in many channels remain elevated despite a weakening economy and consumers have to manage inflationary headwinds that might impact their disposable income available to spend on therapy. Beyond direct media spend, we've been looking to optimize our cost structure in our consumer business and took a number of additional steps at the end of the quarter that should improve cash flow generation in that business throughout the remainder of the year.

Third, we continue to focus on making Talkspace, a platform of choice for our network. As we discussed last quarter, we made changes in the compensation structure for our independent contractor network as well as improving the design functionality of provider dashboards. We reinvested in training and development. We've added resources to our recruiting efforts. And as a result, our ICP network added more therapists in the second quarter than we've added in the 2 previous quarters combined, many of whom are now completed their onboarding and training and are ready to meet the increased demand we expect to see from our B2B customers.

In addition, the average therapists on our ICP platform devoted more time to Talkspace in the second quarter, which also expanded our platform's capacity. As I talked about in our last call, we needed to make changes to the clinical efficiency and engagement of our W2 or NTP network. And unfortunately, we were not able to operationalize many of those changes in Q2. But we've now begun to take action necessary to improve both the efficiency, the engagement and the productivity of that network.

This network's inefficiency negatively impacted our margins in the second quarter. But as a result of the actions we've taken during the start of Q3, you'll see us convert a number of W2 therapists back to independent contractors and reduce the size of this network temporarily. We've also now begun to hire new full-time therapists with clear expectations for the role on the platform as full-time employees. As I mentioned in our last call, we would hope to see margins improve as more of these initiatives and changes take effect throughout the remainder of the year.

Finally, we want to focus on optimizing cash flow, which remains a priority across all of our business. Here too, I believe we continue to make progress. We've improved our B2B revenue collection in part through greater automation and progress in our billing and collection processes this quarter and further improvements there are expected throughout the year. We've upgraded our real-time reporting systems, which gives us greater visibility into account level profitability and unit economics and therefore, enables us to make more rapid decision-making and more robust pricing decisions.

And beyond the reduction in media spend and the actions we've taken on the clinical side of our W2 network, we've also identified a number of opportunities to further reduce operating expenses, and we continue to expect to take actions through the remainder of 2022 that will reduce our EBITDA cash burn each quarter. We believe we have more than sufficient cash to invest in continuing to grow and strengthen our businesses, while at the same time, drive the business towards cash flow breakeven and ultimately to deliver value to our stakeholders over time.

With that, I'll turn the discussion over to Jennifer.

Jennifer Fulk - *Talkspace, Inc. - CFO*

Thank you, Doug, and good evening, everyone. Consistent with prior quarters, I'll speak to sequential trends as we believe this view provides useful context given the meaningful operational initiatives we implemented since November and the ongoing revenue mix shift driven by strong momentum in our B2B business. Starting with Slide 5. Second quarter revenue was $29.8 million, down 1% sequentially from the first quarter. Second quarter B2B revenue was $14.6 million, up 13% sequentially on a reported basis. Performance was driven primarily by double-digit growth in DTE revenue and more modest growth in B2B sessions.

B2C revenue was $15.3 million, down 11% from the first quarter on a reported basis. The lower number of active users was partially offset by lower promotional activity and an increase in ARPU as a larger portion of our members selected subscription plans with live video content. As you see in our footnotes, we classified post-session member payments as B2B revenue in the second quarter. Our work to improve collections resulted in a meaningful increase in post-session payments in the first half, which drove further analysis regarding this revenue classification, which we believe is better matched to B2B revenues. We have previously reported this revenue as B2C in the first quarter.

On a comparable basis, B2B revenue would have been up 6% and B2C revenues would have been down 7% quarter-on-quarter, had we not made this adjustment in Q2. We do expect continued improvements in collections and resultant cash flows. Second quarter gross profit declined 3% sequentially to $14.5 million. Gross margin at 48.7% was down approximately 110 basis points from Q1 due primarily to our revenue mix shifting toward our B2B business as well as a full quarter impact from the therapist compensation increase that we implemented in Q1.

Turning to Slide 6. Second quarter 2022 GAAP operating expenses were just under $36 million, down slightly from the first quarter. Excluding stock-based compensation, Q2 expenses were approximately $32 million compared to $34 million in the prior quarter, driven by lower media spend as we held headcount and other corporate-related expenses fairly consistent quarter-over-quarter. Second quarter net loss was $23 million. Adjusted EBITDA loss narrowed to $17 million, an improvement of $1.5 million compared to the first quarter. This was driven by improvements to unit economics in the B2C business and growth in B2B.

These were partially offset by our investments in scalable operations to support further business growth, including processes and controls. We continue to maintain a strong balance sheet with $167 million of cash on hand as of June 30. We believe this offers great flexibility to fund operations and invest in our growth initiatives for the next 2 years.

Turning to Slide 7 to look more in depth at B2B performance. Second quarter B2B revenues were up 13% from the first quarter on a reported basis and up 6% on a comparable basis. Performance was driven by 18% sequential growth in DTE revenue as we added 16 new accounts during the second quarter and had the benefit of several large accounts launched late in Q1. In our payer business, we ended the quarter with 77 million eligible lives, a slight increase from Q1. We expect, as Doug mentioned, to add additional lives in the back half of 2022 as we operationalize new markets for existing large national providers.

While lives were relatively flat in the quarter, we saw an acceleration in B2B user registration, driven by our work to leverage the consumer funnel and make it simpler for covered members to access the platform. Several changes made to the user experience in B2B during the quarter, including launching our session modality screens, negatively impacted conversion in the quarter. So that trend has now been reversed. We expect penetration to continue to increase as we continue to enhance the conversion of B2B visitors into our platform.

Turning to Slide 8 for a closer look at our B2C performance. B2C revenues were down 11% sequentially on a reported basis and down 7% on a comparable basis, excluding post-session payments. As I mentioned earlier, performance was driven primarily by a 9% decline in active numbers, partially offset by an organic increase in average price and fewer discounts. While at this moment, we are not seeing any change in our consumers' behavior and customer acquisition cost has become more favorable for the second quarter in a row, we are also aware that the macro environment is softening. This could potentially be a headwind for our B2C business but may also serve to accelerate member enrollment through our B2B business where the cost of therapy can be primarily covered by the members' health benefits.

Turning to our conclusion on Slide 9. As Doug mentioned in his remarks, we are encouraged by the progress we made to date, which continues to drive growth in our B2B business, optimize unit economics in our B2C business and improve the experience for our therapists. We believe that our initiatives and focus on disciplined execution will yield improvement and performance and ultimately, profitability over time for our stakeholders.

And with that, we will open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Ryan Daniels with William Blair.

Jack Senft

This is Jack Senft on for Ryan Daniels. To start off, I'm just kind of curious what you guys are seeing on the wage inflation front. And if you have any more color on that, does it pertain to hourly wages versus salaried? And then to even kind of take this further, are you seeing any further headwinds as it relates to this? Or I mean even other opportunities or initiatives you can implement to help kind of curb this. Any color you'd have on this would be appreciated.

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

Yes. Jack, it's Doug Braunstein. Thanks for the question. We -- as we spoke about earlier on the call, we took an increase to the level of compensation that we paid to our therapies early in the first quarter, and that took effect mid-first quarter. And so the -- in part, the pressure on margin in the second quarter was reflecting in part that increase in compensation. We believe, based on where we are today, our level of compensation is quite competitive and attractive. And as you heard, our recruiting in our independent contractor network, our 1099s, we recruited more therapists to the platform this quarter than we did in the previous 2 quarters combined.

We have much more work to do on the efficiency level of our W2 network, but that's really not an inflationary issue. That's an efficiency issue for us. And I would say across the platform for our full-time non-therapist employees, we, like others, face the challenges of a more difficult recruiting environment. The good news for Talkspace in part is we tend to attract individuals who also are quite mission-driven. And that has worked to our benefit in terms of people being attracted to come work on the platform and stay on the platform because of the important work we do for our members.

Jack Senft

Awesome. I appreciate that. As a quick follow-up into, I know one of your goals was to target larger accounts, which was seen in, I mean, evidenced by the $1 million consigned last quarter. Just kind of curious if you have any updates on selling to these larger accounts, you can comment? And then two, are you having to kind of change your strategy on selling to the B2B side just given the reduced B2C spend? Just kind of thinking about this with the less B2C spend, just thinking maybe less possible brand awareness and maybe a possible challenge for selling to B2C. Just any update you have on that would be great.

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

Yes. So actually, part of what we mentioned in the call is actually our traffic to the site and our cost -- our traffic went up in the second quarter and our cost per visitor went down, both very favorable. And what we also mentioned is because of that unified funnel change we made late in the first quarter, we're now driving through our B2C site, a significant increase in B2B customers who are able to come into the website now and seamlessly find whether or not they have coverage through one of our payer partners or EAP plans, and then to stay within the site and literally sign on as a B2B member. So that's been actually quite advantageous for us, and we expect to continue to see more traction there, particularly as we add additional covered lives in the back half of 2022.

I would say the first part of your question around DTE. We did sign up a number of large accounts during this quarter. But what we are seeing is for many of the accounts which were in active discussions, they are deferring implementation and decisions to the beginning part of 2023 as a much more holistic view on what benefits and what cost they're going to commit to for their employee populations. We've got quite a number of very attractive, engaged discussions with large clients. So our targeting and our efforts there are improving the flow of discussions that we have.

But I -- as both Jennifer and I cautioned the timing to actually get the implementation for a number of those large accounts given the macro environment, it may be lumpier than we would have otherwise hoped and expected it to be during the course of '22.

But you should rest assured for most employers today and for many, many of their HR executives, delivering incremental benefits for behavioral health care remains a top-tier priority. And so the level of engagement and discussion remains very robust for us.

Operator

Your next question comes from the line of Stephanie Davis with SVB Securities.

Anna Kruszenski

This is Anna Kruszenski on for Stephanie. I was wondering if you would be able to pivot some of the B2C cost base into the business to improve the B2B margins? Or have those margins may really be able to expand as the business scales?

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

Yes. So Anna, one of the things that we absolutely have done during the first 6 months of 2022 is we have pivoted a fair amount of the savings that we experienced in the B2C business by our almost 50% reduction in media spend and deployed that against more salespeople in B2B, more customer support in B2B, more technologists to do implementation of new product in B2B. So much of that savings has really been designed to drive revenue and then improve our collection of that revenue and improve the customer journey and experience for our B2B members.

The margin is really partially a function of optimizing our W2 network, which, as I said, that was for me, a little bit of a disappointment in terms of the progress in Q2. We didn't make as much progress as I had anticipated, but we've taken a number of actions at the beginning of Q3 that we hope will begin to demonstrate improvements in margins in the back half of the year. And the other opportunity that we've got in the B2B space, quite frankly, is to optimize our pricing strategies, which, again, we look forward to the back half of the year as an opportunity to really take advantage of that.

Anna Kruszenski

Got you. Great. That's really helpful. And then just a quick follow-up. I was wondering if you could talk about your strategic alternatives (inaudible) given the current macro and just the current [news] flow of [back] M&A?

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

Well, I don't think our position has changed at all, which is we continue as a management team and as a Board to be extremely focused on optimizing shareholder value. And the course in front of us, which Jennifer and I feel quite strongly that we've made a lot of progress in the last several quarters is to improve the revenue with the B2B business, optimize our B2C and really begin to focus on reducing our cash burn and moving this company towards cash flow breakeven. We remain open to doing that both on a stand-alone basis and open to any strategic dialogue that we think, get to the shareholders to value creation in a more expedited and more efficient manner.

But we're going to keep the management team focused on doing what we can to improve our business. And then we remain open to whatever opportunities are out there. I will say, by the way, on the growth side from a strategic standpoint, there are -- we've had -- we've been approached by numerous companies in the -- that are private today where funding has become much more challenging, and we are taking a very disciplined approach to thinking about are there product extensions that we can add, but we maintain our focus on our path towards profitability and cash flow breakeven.

Operator

(Operator Instructions) There are no further questions at this time.

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

So operator, thank you, and I appreciate everyone participating. Obviously, we know it is a very busy period in time. There's lots of calls to make. We look forward to engaging both with our sell-side research and our investors in the coming days to answer questions that they might have. And again, on behalf of Mike and Jennifer and myself, we appreciate the time, and we look forward to continuing to update this group on our ongoing progress to really deliver value to our constituencies. So thanks for participating in today's call.

Operator

This concludes today's conference call. You may now disconnect.