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Earnings Call

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Call Participants

EXECUTIVES

Jeannine Feyen
Director of Communications

Jennifer Fulk
Chief Financial Officer

Jon R. Cohen
CEO & Director

ANALYSTS

Jack A. Senft
William Blair & Company L.L.C., Research Division

Lucas Cole Romanski
TD Cowen, Research Division

Presentation

Operator

Thank you for standing by. My name is Kayla Baker, and I will be your conference operator today. At this time, I would like to welcome everyone to the Talkspace Third Quarter 2023 Earnings Conference Call. [Operator Instructions]

I would now like to turn it over to Director of Communications, Jeannine Feyen. You may begin.

Jeannine Feyen
Director of Communications

Good morning, and welcome to Talkspace's Earnings Conference Call for the Third Quarter of 2023. I am Jeannine Feyen, Director of Communications. I hope you've had the opportunity to access the press release we posted on Talkspace's IR website and the presentation of our earnings results. We'll use the presentation to walk you through today's remarks. Leading today's call are our CEO, Dr. Jon Cohen; and our CFO, Jennifer Fulk. Management will offer their prepared remarks, and we'll then take your questions.

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.

Now I will turn it over to Dr. Jon Cohen.

Jon R. Cohen
CEO & Director

Thanks, Jeannine, and thank you all for joining us today. I am pleased to report that Talkspace had another strong quarter as we continue to execute on our strategic initiatives and path to profitability.

Before I begin, I'd like to acknowledge that November is Men's Health Awareness Month, also known as Movember. This initiative holds significant importance to Talkspace as we advocate for mental health, a topic that often face a stigma among men. We are proud to play an active role in promoting and encouraging men to reach out for the help that they need. We are still a long way from achieving mental health parity, but campaigns help to shed light on this important group.

If you happen to be in Times Square this week, look for our compelling campaign on Nasdaq's billboards featuring Michael Phelps, a long-time advocate for mental health awareness for everyone. The message is clear: check in on men. It's more than a slogan, it's a call to action intended to include men in the mental health conversation. Movember builds on our recent mental health awareness campaigns that bring these important issues to the forefront, including World Mental Health Day in October and recent news that a bipartisan group of senators have actually crossed the aisle to form a mental health caucus.

These events demonstrate how mental health is increasingly recognized as a topic that impacts on everyone and follows the results of our new normalization survey that I discussed on our last earnings call, which found that almost everyone now shares their experience with therapy with their friends and families. And while we continue to grow and improve our platform and services, we continue to receive strong praise from the industry. Most recently, we were honored that Verywell Mind named Talkspace as the most comprehensive online therapy service of 2023. And Crain's New York Business listed us among the 2023 Best Places to Work, validating our efforts to create an inspiring work environment.

This quarter, we continue to build on our team of seasoned behavioral health leaders by welcoming our new Chief Medical Officer, Nikole Benders-Hadi, to our executive team. In this role, Nikole will oversee clinical quality and research as we continue to deliver the highest-quality digital mental health care at scale. With over a decade of clinical experience, she will be pivotal in elevating the company's clinical offering, including leveraging our data and technology to deliver better patient engagement and outcomes.

Let me now turn to our financial results. Consolidated revenue grew 32% year-over-year to $38.6 million, driven by sustained momentum in our B2B categories, which was up 79% year-over-year. Our payer revenue grew 132% year-over-year, driven by the strong growth in our payer sessions, demonstrating our ability to activate user engagement across the platform. This quarter's performance in the payer business occurred as a result of our work on raising awareness in our covered lives base, paired with our focus on member experience and clinical quality and continued improvement in time to access.

The teams worked over the last few quarters to optimize the business platform again yielded strong results, as we drove top line results while reducing our cost base year-over-year by $10.4 million to $24 million. We delivered another quarter of reduced adjusted EBITDA loss, which came in at $2.8 million, a $1.2 million sequential improvement and $12.7 million improvement year-over-year, and we continue to make meaningful progress in our revenue cycle management and our treasury functions.

You may have seen that last month, we announced the results of using our unique artificial intelligence algorithms to detect individuals at risk for self-harm or suicide. Leveraging our large language machine learning capabilities, the Talkspace platform can detect patterns to identify individuals at risk for self-harm. The analysis runs real time and sends an urgent alert to the therapist. We continue to utilize and identify new ways for artificial intelligence to improve the quality of care delivered by our therapists and improve our operational efficiencies across the platform.

Let me now move to the incredible progress we continue to make against our 4 strategic initiatives. Our first strategic priority is to drive payer revenue growth by adding covered lives, increasing the number of active users who are covered by their behavioral health benefits and employee assistance plans as well as focusing our efforts to make people aware of these benefits to improve our capture rate. These efforts continue to be successful.

Third quarter payer revenue was $22.1 million, up 19% sequentially and 132% year-over-year. Session volume was up 14% sequentially from just over 200,000 to over 228,000 sessions, more than double Q3 from last year. Session growth was driven by a number of our actions, including enhancing our user experience, improving immediate access and relentlessly focusing on clinical quality. This has directly contributed to the higher portion of existing users returning for more sessions within a shorter period of time as well as new users accessing the platform. We remain the largest in-network provider of telehealth mental health services in the country, and we continue to strengthen our position as we anticipate the launch of more than 15 million additional behavioral health, commercial covered lives in the next few weeks. We expect the activation to gradually ramp over the next few months and to contribute meaningfully to our 2024 results.

Another area for growth is partnerships, which can be an effective channel to drive broader awareness of our payer member offering while advancing the message that mental health is essential to overall well-being. We recently announced the collaboration with OURA because sleep health is an integral part of mental health. This is a first-of-a-kind partnership which allows OURA users to share an easy-to-understand sleep report with their Talkspace therapists. Both companies share this new capability with their member base through own marketing channels. Watch for more partnership announcements in the coming months.

Our second strategic initiative is to grow our direct-to-enterprise business. Our DTE business was up 10% year-over-year to $8 million but remained flat over Q2. The team continues its work to build out a strong pipeline of new clients in existing and new verticals. As I previously discussed, we believe that a vitally important segment of society suffering from mental health issues are adolescents. Our investment in this area is now bearing fruit, and that although I cannot yet provide specifics, we plan to make several announcements in the next few weeks around delivering the Talkspace solution to adolescents for more than one large jurisdiction. This places us in a unique position to capture more of the team's total addressable market, which we estimate to be over $500 million. Overall, our DTE pipeline remains robust, is growing and is well-rounded as we move into the fourth quarter and into 2024.

Our third strategic initiative is to be the platform of choice for providers. Year-to-date, we have grown our provider network to nearly 1,800 providers, an almost 60% increase since the beginning of the year and now have over 4,800 providers. Churn has remained relatively flat over this time as we continue to maintain stringent clinical quality and hiring standards. In addition, we continue to make investments to improve the workflow and experience of the therapists utilizing our platform.

Therapists' NPS scores continue to improve quarter-over-quarter as a result of these new initiatives we launched, including providing more transparency around compensation and pay tracking, improvements to our initiative that allows providers to focus on the work they find most meaningful and improved training and one-on-one support. These initiatives have had tangible results as access metrics continue to improve. In Q3, average match times were consistently under 1 hour, and the median time to live video sessions were under 7 days.

Our fourth initiative is to continue to achieve profitable growth by driving operational excellence. The team has made significant progress over the course of the year to identify cost savings across the platform to maximize efficiencies and increase operating leverage. In the third quarter, our cost base was slightly down sequentially and down 30% year-over-year to $24 million, while overall revenue grew 32% versus the prior year period. As a result, we further narrowed our adjusted EBITDA loss to $2.8 million, down 82% year-over-year. Finally, we continue to build out our financial controls and processes and make progress towards achieving SOX compliance.

In summary, as I look towards 2024, Talkspace is in a very strong position to be a dominant leader in the mental health space, as we achieve breakeven by the end of Q1 of 2024 with significant cash available for further investments. Several major factors put us in a strong position for success. Mental health parity has come to the forefront. Telehealth for mental health is now widely accepted, testing is a proven solution, funding is increasing from multiple entities, access to care on the platform is frequently less than 24 hours, the service is affordable through our large payer network, we are national in scope and the demand for mental health services is enormous. We anticipate a significant increase in covered lives in 2024, providing even greater access to a significant portion of the entire U.S. population. Our meaningful growth prospects in our DTE business, most notably in adolescents, are adding exciting opportunities that will drive revenue growth momentum and profitability in 2024.

With that, I'll turn the call over to Jennifer to walk through the financials.

Jennifer Fulk
Chief Financial Officer

Thank you, Jon, and good morning, everyone. We are pleased with the results that we delivered in the third quarter as strong execution across our company priorities continue to translate in our financial results. My comments today will be based primarily on the third quarter results on a sequential quarter-over-quarter basis, unless otherwise noted. I will cover highlights from our financial results and then give more details on our outlook.

Starting on Slide 5. Total revenue for the third quarter was $38.6 million, an 8% increase over the second quarter and a 32% increase from a year ago. B2B payer revenue maintained strong growth with an increase of 19% sequentially to $22.1 million, with session volume growth of 14% and net price growth of 5%. Sessions completed by behavioral health and EAP members grew to over 228,000. This continued strong growth was driven by an increase in capture rates, both from the covered lives we added early in the second quarter as well as additional capture rate of existing covered lives. We also expanded session utilization by members on the platform, driven by product enhancements supporting both the provider as well as the member experience. Covered lives grew 31% year-over-year and 3% quarter-over-quarter to 113 million. As Jon noted, we anticipate adding approximately 15 million more covered lives in the next few weeks. Expanding our coverage further will help support momentum and volume growth as we go into next year.

Turning to net price growth of 5%, this was driven primarily by further improvement in our collections as our revenue cycle management team continue to find opportunities to drive higher collections rates. The Q3 results include a onetime benefit of $400,000 related to Q2 and prior period collections. We are very pleased with the strong execution of the team on this important and complex core capability.

In the direct-to-enterprise category, revenue remained flat sequentially at $8 million. As we noted last quarter, we've had some attrition from accounts onboarded during COVID, offset by new customer additions. As Jon noted, we are making inroads into new verticals with large unmet demand and have clear line of sight to the growing value of the pipeline and the launch of new sizable accounts in the next few weeks. While we make it only partial revenue benefit for these new initiatives in the fourth quarter, we are excited about the meaningful financial impact we expect for 2024.

Turning to the consumer category. Revenue was $8.5 million, a 6% decline sequentially. As expected, this decline continued to moderate versus prior quarters as this out-of-pocket category is most exposed to discretionary consumer spending trends, but at the same time, benefit from the work we do to enhance the experience for all members regardless of how they pay.

Finally, turning to gross profit. Total third quarter gross profit grew 6% sequentially and 29% year-over-year to $18.8 million and gross margin was 48.8%, slightly below last quarter. This primarily reflects the revenue mix just towards the payer category.

Turning to Slide 6. GAAP operating expenses decreased 1% or $200,000 sequentially and 30% year-over-year to $24 million. Excluding stock-based compensation, Q3 expenses were approximately $22.1 million, flat over second quarter levels and 27% or $8.3 million lower than last year. As I mentioned in our last call, we have made important progress to optimize our cost structure over the last several quarters. We have built our core capabilities for scale, and we believe we can drive meaningful operating leverage at this level.

Turning to profitability. Both payer revenue and gross profit growth resulted in another quarter of significant improvement in adjusted EBITDA loss, which improved 30% sequentially and 82% year-over-year to $2.8 million. Turning to the balance sheet. We maintained a very strong cash position with $125.3 million in cash and cash equivalents at the end of the third quarter, down $800,000 sequentially from Q2.

Turning to Slide 7. Let me highlight a few points from our update to our outlook for 2023. First, based on strong payer revenue in the third quarter and continued trends in October, we are raising the full year 2023 revenue guidance to approximately $146 million, up from $137 million to $142 million previously estimated. Our guidance for the fourth quarter factors in the moderated growth we saw across payer and consumer volumes during the second half of Q4 last year and as discussed, minimal impact from new covered lives and DTE account launches we've referenced. And for our full year 2023 adjusted EBITDA loss, we now estimate a range of $16 million to $17 million, the high end of our previous range, driven by top line expansion in our third quarter results as well as network and other onetime costs we will incur as we prepare the organization for the new near-term launches. Lastly, we are reaffirming our belief we will reach breakeven adjusted EBITDA by the end of the first quarter 2024 and expected cash balance of approximately $120 million.

Let me close with a few highlights from today's call. First, we continue to be excited about our progress and future prospects for both payer and DTE. In payer, we continue to have conviction in our ability to expand our covered lives base while increasing capture rates and utilization. And in DTE, we are excited about the value of our pipeline, our opportunity within new verticals and the new accounts we anticipate adding in the next few weeks. We believe both of these categories will be growth contributors in 2024 and beyond.

Second, we believe that the ability to leverage our streamlined cost structure will benefit us going forward as we scale both the payer and the DTE revenues. We will continue to allocate resources selectively while ensuring we are funding our most compelling growth investments. And finally, as you can see, we have exciting opportunities and important work to do in the next few months, including adding new covered lives, launching new DTE verticals, optimizing member acquisition in the first quarter and reaching adjusted EBITDA breakeven. We look forward to providing more context of how we anticipate our efforts to impact our financial results and plan to provide full year guidance for 2024 in the first quarter when we review our Q4 results.

With that, we will open the call for Q&A.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Charles Rhyee with TD Cowen.

Lucas Cole Romanski
TD Cowen, Research Division

This is Lucas on for Charles. Looking at your updated 2023 guidance, it implies that you're going to see flat revenue growth in 4Q sequentially and then no improvement in adjusted EBITDA in the fourth quarter as well at the low end of your adjusted EBITDA guidance range. Given that we're going to see the launch of about 15 million lives in the EAP business over the next few weeks, I guess the likelihood of realizing your adjusted EBITDA breakeven target this year is a possibility. So I guess I kind of want to hear your thoughts on how we should think about that. And then I guess looking out into 2024, I understand you guys aren't giving guidance on that yet, but maybe how should we think about it qualitatively seeing growth in both the DTE and EAP businesses?

Jennifer Fulk
Chief Financial Officer

Thanks, Lucas, for the question. So maybe I'll answer both questions by recapping some of the comments we made earlier. So on the fourth quarter, that is correct. So I mentioned on the revenue line, we anticipate similar trends that we had last year in volumes, and that's related to both supply from our therapists around the holidays as well as demand. So we saw a slowing of growth. We still had growth in the fourth quarter of last year. We anticipate the same thing this year.

The new launches that we referred to over the next few weeks, specifically on the covered lives, as you know, as we add covered lives, that doesn't lead to immediate incremental revenue. It's the pull-through to capture rate that translates into revenue. And with the launch late in the year and going into that holiday, the holidays that I mentioned before, this is -- these are the reasons we anticipate minimal impact on our revenue line for this year, but that having a larger impact as we start 2024.

So that's on the revenue line. On adjusted EBITDA, so I mentioned earlier, specifically the impact is we ensure we've got capacity and operations in place to launch both the new DTE accounts as well as the payer lives. We anticipate there could be that impact on adjusted EBITDA. That's what's anticipated in our outlook for the fourth quarter. But as we go into next year, of course, we see these as being beneficial both on the top line and on adjusted EBITDA.

Lucas Cole Romanski
TD Cowen, Research Division

Okay. And then I also want to ask about the opportunity you guys have with school systems. Obviously, a great opportunity to serve an underserved population. But you mentioned $500 million in TAM. Can you just share a little bit about what makes this market an attractive one for Talkspace?

Jon R. Cohen
CEO & Director

Sure. So thanks. It's Jon. The -- if you look at the DTE, the direct-to-enterprise, we serve employers, both large and small. We serve colleges and universities, some cities. And then as we've stated, the 13-plus, usually 13- through 17-year-old population. The reason that's so important, a variety of reasons. One is, as you probably know, the -- there's just an incredible need in that population, given everything that's going on with students. There's not a day that doesn't go by that you don't hear something else about what's going on in that population.

We think it's a really important opportunity for us because, first off, the Talkspace platform is very amenable to students because of the texting and messaging platform that we have and developed.

So that's a great way to actually be in contact with students. It is available essentially 24/7. We call it asynchronous. Obviously, the therapist doesn't immediately get back to everybody instantaneously, but the ability to text and message pretty much any time makes it a really, really viable solution for students.

Given what's going on in the schools and/or that population, we know that it is a very, very large opportunity. There's roughly 25 million high school students in the country, so you could do the math about what that represents on a per student per month fee. So the $500 million number actually is probably relatively conservative in the big picture. And as you heard me in the comments, we will make some announcements within the next couple of weeks about some of those opportunities.

Operator

[Operator Instructions] Your next question comes from the line of Ryan Daniels with William Blair.

Jack A. Senft
William Blair & Company L.L.C., Research Division

This is Jack Senft on for Ryan Daniels. First, a similar question to the one that was asked before, but I'll ask it in a different way. Just in terms of general demand clinician capacity, 2022 was somewhat of a pivotal year for you guys going away from DTC. Kind of how should we think about growth into 2024 besides the covered lives you already noted that will be onboarded shortly?

I know you're not guiding for 2024 specifically, but in terms of general demand trends with the selling season, just kind of what are you seeing on that front and how that translates into top line visibility? Are you assuming additional covered lives in quarter 1 to be onboarded? Or just kind of generally, what's your visibility there?

Jon R. Cohen
CEO & Director

So we've told people frequently that we now have 110 million covered lives. If you look at the U.S. population of roughly 360 million people, there's some significant opportunity to increase that number. We will increase the number of lives next year through a variety of ongoing negotiations and a very, very substantial pipeline into the lives that are currently not covered but are on our pipeline. And we believe that will be implement -- we know will be implemented in 2024. So that's one.

The second, you've heard me talk about the DTE organization is just beginning to hit its stride after being rebuilt over the last 6 months. The pipeline there, both on the employer side, colleges, universities. And as you heard me talk about, 13- to 17-year-old is very substantial. So we expect both parts of the business, both the behavioral health reimbursed benefit side and the DTE side to grow in 2024.

Jack A. Senft
William Blair & Company L.L.C., Research Division

Okay. Great. And then just a quick follow-up, too. So total operating expenses as a percent of revenue decreased again sequentially. Right now, it looks like it's about 62% of total revenue. I know historically, fourth quarter is often the highest in terms of margins there. Maybe just on a full year basis, is there a number you guys are targeting here? I guess like how should we think about this going forward as you kind of press on the -- press forward on the operation improvements?

Jennifer Fulk
Chief Financial Officer

Yes. So I would think about our Q3 OpEx, which was nearly flat to Q2 is the right way to think about these levels. So staying in the area of that as we scale the revenue line both in terms of the payer and DTE categories. So I've referenced before, we've made quite a bit of investments in the last several quarters in ensuring that our platform is built for scale. We've spent a lot of time and resources building the core capabilities we need to support that scale, including the revenue cycle operations as well as investments in the platform to -- for the network. So we've done a lot of those things. I think there are things that we can keep doing to drive enhancements throughout the funnel and in the member and the therapist

-- I'm sorry, member experience. But I think, by and large, we see opportunity to continue to reallocate resources and invest in those things while maintaining our OpEx base where it is. So the short answer is we believe that we can scale from here and drive leverage through the top line.

Operator

And there are no further questions at this time. Dr. Jon Cohen, I turn the call back over to you.

Jon R. Cohen
CEO & Director

Well, thanks again to everybody for joining. To conclude, our third quarter results demonstrated strong progress against our strategic plan. Our continued momentum across the payer business, coupled with operational improvements and expansion of our clinical capacity, are important enablers as we deliver on our mission of expanding access to mental health care and are grateful for the continued support of our shareholders. Thank you for joining us today.

Operator
And this concludes today's conference call. You may now disconnect.