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Earnings Call

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Call Participants

EXECUTIVES

Jeannine Feyen
Director of Communications

Jennifer Fulk
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Jon R. Cohen
CEO & Director

ANALYSTS

Charles Rhyee
TD Cowen, Research Division

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

Presentation

Jeannine Feyen
Director of Communications

Good morning, and welcome to Talkspace's Earnings Conference Call for the Second Quarter of 2023. I'm 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 use this 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 against our strategic initiatives and rapidly progress on our path to profitability. The strong results in this quarter provide us with the confidence that we will exceed our original guidance and to raise our fiscal 2023 revenue and adjusted EBITDA targets, as I will discuss shortly. In addition, I am particularly excited to relay that this quarter, we were cash flow positive for the first time since becoming publicly traded, which Jennifer will discuss later. Before I turn to our financial results, I want to call out 3 important mental health reformats that were published this quarter. The Surgeon General issued a new advisory about the effects of social media use on youth mental health as one of the greatest threats to Team Health since cigarette smoking. In another report, loneliness is a huge issue for 36% of Americans, 61% of youth and 51% of mothers, reporting serious loneliness with associated increases in depression and anxiety and a third report, a 22% increase in mental health emergencies in teenage girls related to a sharp rise in hospitalizations for eating disorders and suicidal behavior.

On the positive side, in June, we released our latest study, the new normalization survey. This describes the recalibration of how people view mental health services. The study found that more people than ever are open to help-seeking health for mental health issues. And just as importantly, are talking about it without fear of the stigma usually associated with mental health conditions and feel that mental health conditions and therapy are now socially acceptable and normal. For example, 90% of respondents currently in therapy say they've shared their experiences with friends and family. Other important takeaways include: 98% of respondents believe mental health treatment should be covered by their insurance regardless of a diagnosable condition in the same way that preventive care is covered for physical health. 86% of respondents also said that getting therapy covered through their employer would make them more likely to stay on their job. All of these reports are powerful indicators that, again, demonstrate the growing need and demand for covered mental health care services across all ages, demographics and geographies. In each of these use cases, the Talkspace platform is strategically situated to address this rapidly growing demand. Now let me turn to the quarter's financial highlights. Consolidated revenue grew 19% year-over-year to $35.6 million, driven by sustained momentum in our B2B business, which was up 82% year-on-year.

Our payer revenue grew 135% year-on-year, driven by a 42% increase in covered lives at the end of the period, a 42% growth in capture rate and a higher sessions per user. This reflects strong and growing user engagement. Such meaningful acceleration in our payer business occurred as a result of our relentless focus on member experience and clinical quality and meaningful improvement in clinical supply and time to access. Our consumer business continued to decline, albeit at a slower pace compared to prior quarters as we continue to optimize our media spend, which is highly correlated to this category. As discussed in the first quarter, we have a psychiatric business primarily for medication management, which we see as another significant area of growth. In the second quarter, we optimized our offering to better serve our recurring subscriber base, improving the unit economics. Furthermore, we started testing a marketing campaign to increase awareness of our prescription capabilities and trained our providers to ensure a more efficient internal patient referral process. Given the strong market demand for medication management, over time, we expect psychiatry to become a larger portion of the overall revenue mix. Our efforts to optimize our business platform continue to yield strong results in the second quarter. We reduced our cost base by another $1.6 million sequentially and $11.4 million year-on-year, while we continue to grow revenue, active users and sessions. This resulted in another significant reduction in our quarterly EBITDA loss, which came in at $4 million, a $2.5 million improvement versus the first quarter and a $13 million improvement year-over-year. We also made meaningful progress in our revenue cycle management and treasury functions, which allowed us to improve revenue collections, which contributed to achieving positive cash flow.

Let me now move to the progress we continue to make on our 4 strategic initiatives I laid out previously. Our first priority is to drive payer revenue growth, which is achieved by expanding the number of active users who are covered by their behavior health benefits and employee assistance plans as well as focusing our efforts to make aware that these benefits are available and improving utilization. Second quarter payer revenue was $18.5 million, up 25% versus Q1 and 135% versus the second quarter last year. We added approximately $12 million net new covered lives in the quarter, while session volumes were up 17% sequentially from 172,000 to just over $200,000, up 109% year-over-year. Importantly, initiatives to enhance our user experience, such as improving immediate access and a relentless focus on clinical quality have resulted in a higher proportion of existing users returning for more sessions within a shorter period of time. As a result, daily active members using their behavior health benefits have grown approximately 50% year-to-date. As we progress into the second half of the year, we will continue to focus on driving higher capture rates and utilization through product enhancements, marketing and initiatives to increase referral. For example, recently, we made it much easier for members to schedule recurring sessions and gave the therapist the ability to select the clinical areas that are most interesting to them and match patients accordingly. Our second strategic initiative is to grow our direct-to-enterprise business. Our DTE business was up 20% year-over-year to $8 million, but down 7% this quarter. This decline was due to a couple of long-term accounts moving to different coverage plans within the Talkspace platform and also the attrition from accounts that had joined Talkspace utilizing COVID funding that is no longer available.

As I mentioned in the last quarter, we are building on our team's capability and as part of that continuing efforts, I'm excited to announce that Natalie Cummins has joined as our Chief Business Officer. Natalie has a history of successfully building large commercial organizations and developing business partnerships. The result of these personnel changes is already having a significant impact as we anticipate significant growth in our pipeline of new clients in existing and new verticals. In addition to growing the pipeline, we are continuing to refine our product and our go-to-market approach and recently launched the self-serve portal, a product aimed at small businesses that allows them to sign up for our services through our website. This enables employees to immediately access our services within a short period of time. We have also intensified our discussions with human resource leaders as they increasingly need MetroHealth products to enhance the well-being and productivity of their employees. A few weeks ago, Talkspace exhibited at the world's largest HR conference hosted by the Society of Human Resource Management, which recorded a record-breaking year of registered attendees. There, we heard from HR leaders and benefits managers about their strong desire to provide employees with mental health support services like Talkspace. While we are looking to add new clients, we remain committed to providing best-in-class services to our existing clients.

As a result of these efforts, the level of customer satisfaction and engagement continues to increase across our account base. Our service strategic initiative is to be the platform of choice for providers. Year-to-date, we have grown our provider network by nearly 1,300 therapists, a 42% increase since the beginning of the year, while churn has remained flat at the beginning of the year as we maintain stringent clinical quality and hiring [standards]. Part of our work in cultivating and maintaining our clinical network is investing in our therapists, providing them with the best training and support tools to enable them to provide high-quality care term members. We've created and maintained an inclusive community and culture while providing the learning and developmental opportunities that support resources to allow for continued professional growth. As I mentioned above, we recently introduced a mechanism that allows providers to focus on clinical areas that are most meaningful to them, which has resulted in a significant increase in provider satisfaction and engagement. On top of competitive pay, we've improved the way we compensate our providers, including a non-financial recognition and a new bonus program for our ICP therapists. These changes have enabled us to achieve industry-leading access metrics and greatly improved overall net productivity year-to-date. Average match times continue to decline sequentially and the median time to the first live video session remains under 7 days. These metrics in turn, help to build on our recruiting brand strength and enhanced member experience as engage providers provide better care. We've carried on with our work leaning into and identifying areas where we can optimize our business processes with the assistance of artificial intelligence. We believe that AI should not be a replacement for the human component of therapy. However, we can leverage AI to support our therapists to improve clinical quality and to help provide clinical documentation.

Our fourth initiative is to continue to achieve profitable growth by driving operational excellence. The team has again made substantial progress on driving cost efficiency while identifying synergies across the platform, reducing our cost base by 32% year-over-year here, while revenues were up 19% during the same time period. As a result, we narrowed our adjusted EBITDA loss to $4 million, down 77% year-over-year. And as I mentioned, we achieved positive cash flow for the first time since being a publicly traded company. Our cash increased by $1 million since the end of the last quarter. This progress reflects a newly built revenue operations team, which has been highly effective in increasing claim submission and adjudication rate and acceleration collection timing as well as enhanced treasury functions. Last, we continue to build a best-in-class control function and have made meaningful progress towards achieving SOX compliance. In summary, we believe that the B2B categories will continue to fuel our growth as we add substantially new covered lives in the second half of the year, maintaining our position as the leading in-network telehealth mental health provider in the country. I am also confident that several large DTE deals will close in the second half of the year. Our strong progress this quarter and to date has led us to upward revise our guidance. For 2023, we now believe we will achieve a total revenue in the range of $137 million to $142 million, up from $130 million to $135 million, while narrowing the adjusted EBITDA loss range to $16 million to $19 million as compared to our prior guidance of $21 million to $24 million for 2023. We also reaffirm that we believe we will achieve breakeven adjusted EBITDA by the end of the first quarter of 2024 with more than $100 million of cash on the balance sheet.

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

Jennifer Fulk
Chief Financial Officer

Thank you, Jon, and good morning, everyone. My comments today will be based primarily on second-quarter results on a sequential quarter-over-quarter basis. I will cover highlights from our financial results and then give more details on our updated 2023 revenue and adjusted EBITDA guidance. Turning to Slide 5. Total revenue for the second quarter was $35.6 million, a 7% increase over the first quarter and a 19% increase from a year ago. B2B payer revenue increased approximately 25% sequentially to $18.5 million with session volume growth of 17% and net price growth of 7%. Session growth was driven by another quarter of increased capture rate. This was the result of continuing to leverage our brand recognition and focus our marketing efforts to drive awareness of our covered benefit and to optimize our funnel. We also grew covered lives by 12% or $12 million in the second quarter. As we mentioned in our last call, we added the entire commercial book of business for a large payer in April, and we are very pleased with the current ramp-up rate for this new book of business. Regarding net price growth, as Jon noted, we have made significant progress within our revenue cycle management capabilities. The net price growth we recognized in Q2 was primarily driven by an increase in our collections rate. Healthcare claims processing is highly complex, but we have firmly established our revenue cycle capabilities as a core competency, and the results demonstrated in Q2 reflect the product enhancements, refined processes with our payer partners and enhanced internal reporting capabilities.

Looking more broadly at this category, our payer member unit economics improved meaningfully in the quarter as a result of progress in revenue cycle management as well as higher user engagement and retention. In the direct-to-enterprise category, revenue declined by 7% quarter-on-quarter to $8 million. As Jon highlighted, this was due to some account migration to other Talkspace offerings and attrition from older, low-utilization accounts. A renewed emphasis on rebuilding our customer pipeline and retaining existing accounts, combined with our product enhancements, is gaining traction, and we are confident in the long-term competitiveness of our offering. Finally, our consumer revenue declined 8% sequentially to $9.1 million. While this is the slowest rate of decline that we have seen in several quarters, as we have commented in the past, this category is highly correlated to our media spend and is also most exposed to consumer discretionary spending trends. This category continues to provide positive contribution and benefit from our all-member approach to our product and experience improvements. Moving to gross profit. Total second-quarter profit grew 6% for payer revenue collection. Turning to Slide 6. GAAP operating expenses decreased 6% or $1.6 million sequentially and 32% year-over-year to $24.2 million. Excluding stock-based compensation, Q2 expense was approximately $22.1 million, a reduction of $1.4 million on a comparable basis versus Q1 and a 30% or almost $10 million reduction year-over-year, demonstrating significant incremental progress in streamlining and strengthening our business across all categories of spend. In corporate spend, we recognized savings from continuing to rightsize our corporate infrastructure. As discussed on our last earnings call, at the end of the first quarter, we reorganized our product and technology teams to focus on a leaner approach against our priority product initiatives. This reduction was incremental to the progress we have made in the last several quarters to drive efficiencies across our corporate infrastructure and third-party spend while at the same time, prioritizing and investing in key growth capabilities and establishing robust processes and controls. In media, we reduced spend sequentially by 11% as we continued our efforts to optimize our unified member acquisition strategy. As I mentioned, we are pleased with our demonstrated ability to leverage our brand and marketing messaging to drive awareness and acquisitions of payer members.

Moving to profitability, both payer revenue and gross profit growth, combined with further OpEx reductions resulted in another quarter of significant improvement in adjusted EBITDA loss, which was down 38% sequentially and 77% year-over-year to $4 million. Turning to the balance sheet. We ended the second quarter with $126.1 million in cash and cash equivalents, up from $125.1 million at the end of the first quarter. As Jon mentioned, we generated positive cash flow during the second quarter, which was primarily driven by net working capital contraction, most notably from our progress to accelerate the payment cycles from our payers, which resulted in a one-time benefit and from interest income. Going forward, we believe cash flow will match more closely with adjusted EBITDA. Turning to Slide 7. As Jon discussed, we are raising the 2023 guidance we provided on our last earnings call. Firstly, for 2023 revenue, we now estimate a range of $137 million to $142 million, up from $130 million to $135 million previously estimated. This is based mostly on Q2 results, including the continued strong payer revenue performance. And for 2023 full-year adjusted EBITDA loss, we now estimate a range of $16 million to $19 million, up from $21 million to $24 million previously estimated, driven by top-line expansion and the scalability of our Q2 cost base. Lastly, we are reaffirming our belief that we will reach breakeven adjusted EBITDA by the end of the first quarter 2024 with a cash balance of more than $100 million.

Let me highlight a few points on the updated guidance. On payer revenue, we believe growth will outpace other revenue categories. This will be driven primarily by the addition of new covered lives as well as continued growth in capture rate and utilization. Regarding the DTE category, we remain confident in our strategy, but as we have described, we believe it will take us some time to demonstrate progress from our renewed efforts in our financial results. And in the consumer category, we expect trends to stabilize through the rest of this year but remain prudent given the macroeconomic backdrop. Regarding gross margin, we expect this metric to remain in the range of Q2 levels as the revenue mix continues to shift towards the payer category, offset by benefits from revenue cycle management and progress in the DTE category. On operating expenses, we have successfully rebuilt our cost base and created the core competencies needed to support profitable growth, and we will continue to maintain a disciplined approach in managing expenses. We believe we can drive further operating leverage from our infrastructure represented in our Q2 cost base.

Before I turn the call over to the operator for questions, I would like to summarize some points from our remarks. First, we remain very enthusiastic about our progress and future within the payer category and have line of sight to continue expanding covered lives, capture rate and utilization. We continue to believe this to be our largest and most profitable growth opportunity. Second, we believe the significant progress we have made to reduce our infrastructure and establish efficiencies throughout the business, enable operating leverage while prioritizing our most profitable growth investments. Lastly, and as Jon described, there is a massive and growing market opportunity, and we believe we have the execution capabilities and product offering to be the leader in mental health care services and to deliver long-term value creation for our shareholders.
With that, we will open the call for Q&A.

Question and Answer

Operator

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

Charles Rhyee
TD Cowen, Research Division

Congrats on the results here. I wanted to ask about the DTE side. You talked about sequential decline and some of that being some shift in the customers moving to a different product, but some that you mentioned around COVID funding. Can you go into that a little bit more? Just trying to understand what percent of your clients over the last few years or coming in using COVID funding. And how many of those clients have been signed on for continued services relative to the ones that may have stopped because of the lack of funding?

Jon R. Cohen
CEO & Director

It's Jon. We won't give a percent, but what I'll tell you is a significant number of small to medium this side at best school districts, particularly utilize COVID funding for mental health services. I think what we're seeing -- and actually, we're at the tail end of that right now because the funding has run out, I would say, several months ago how long already. So those districts or whatever are just going to have to make a decision about what they're going to need going forward. I don't consider it a substantial risk moving forward at all. It's just something we're calling out because that was the cause of some of the attrited accounts.

Charles Rhyee
TD Cowen, Research Division

Yes. I was just curious because I was just thinking of the diverse. Have you seen a lot of these in these school districts and others that have used that funding, find other sources of funding to continue the service for their...

Jon R. Cohen
CEO & Director

Yes. So what I would tell you is that the market for K-12, particularly 13 and above is actually -- let's put this way, there's significant interest in the market right now to fund those schools and the school districts. So there's an enormous amount of activity relative to what's the next movement for that particular group of individuals. So I would say that despite the COVID funding, what we're seeing in the market is significant interest.

Charles Rhyee
TD Cowen, Research Division

Okay. That's helpful. And then I think Jennifer, you talked about obviously cash flow positive in the quarter, and that's great news. And is that really just more from your side of the claims processing with recycle management? Or has there been a change at the payer level? I know in other areas of health care, people have noted that payers have slowed down payments or there's been a lengthening of DSOs. Just curious if this is really more just from internal improvements? Or are you seeing payers reimbursing faster?

Jennifer Fulk
Chief Financial Officer

Yes. No, Charles, it's certainly due to the hard work that we've done really within the whole process of revenue cycle management, including the treasury operations and ensuring we've got line of sight, and we are as quickly as possible collecting the cash from that. So it's certainly all the progress we made in the second quarter is a reflection of our really hard work that the teams have done.

Charles Rhyee
TD Cowen, Research Division

Great. And sorry, my last question, you talked about launching with a big partner, I think, in April. Can you talk a little bit more about how that's going? I know you made some comments that it's going well and is ramping well. But I just understand the dynamics of how you enter our face with their members? Are you able to go in directly? Or is it still really driven by your health blank customer to really push the product? Just trying to understand where you can push to be able to increase enrollment and et cetera.

Jennifer Fulk
Chief Financial Officer

Yes. So Charles, as we've talked about before, just the payer utilization and our interaction from our payer teams and relationship teams really varies by payer. What we're excited about and with the payer that we launched in the second quarter is a really great collaborative approach. So we were brought on with a lot of excitement from their internal sales team, and it means that we're often at the table, helping to explain the value that Talkspace brings to their customers and with this new interest. So we're really pleased with the way that launch has gone and with the collaboration with that payer. And like Jon said, we look forward to more of that this coming year.

Charles Rhyee
TD Cowen, Research Division

And just to be clarified, this is on the EAP side, you can sign on at any point during the year versus maybe just the behavioral health side, which would be more for a traditional 1/1 start next year.

Jennifer Fulk
Chief Financial Officer

Yes. And so the lives we launched in April were behavioral health, but what we're seeing as far as they're not being necessarily 1/1 trigger since as we're put on both for behavioral health and for [EAP] lives, where we are set as an in-network provider and that can move be at any point during the year.

Operator

Your next question is from the line of Ryan Daniels with William Blair.

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

Yes. Congrats on a good quarter. This is Jack Senft for Ryan. Back to the DTE side of the business. I know you mentioned that school districts might have been a good component of these lost clients. But could you provide a little bit more color on the low utilization of any clients that you lost and any implications you're seeing for the overall demand environment going forward? Are they shifting to lower-cost options? Or are they no longer seeing a need for mental health benefits given the low rate of utilization?

Jon R. Cohen
CEO & Director

Yes. I would say a couple of things. One, we talked about some of the COVID funding. But there was also some other client, really one particular but those clients that have shifted to a different part of the Talkspace platform. So they've moved from a DTE relationship to more of an EAP behavioral health that has occurred. I just want to be clear, it's not like they don't want mental health services. They were just looking at a different way for us to supply that need. I would say, in general, we are spending a fair amount of time or the commercial team rather to make sure that the HR executives utilize the service and actually promote it to their employees and to make sure that the employees know that the service available. So we partner proactively with the employers if there's low utilization to actually improve it. Certainly, some of them are going to see low utilization, but we continue to refine our market strategies with them to increase that need.

Jack A. Senft

William Blair & Company L.L.C., Research Division

Got it. And then I guess my second question would be around gross margins and how you're thinking about that in the long term, given your mix shift towards the payer category that looked to be about 70% of your B2B revenue. So just curious how you're thinking about gross margins going forward.

Jennifer Fulk
Chief Financial Officer

Yes, Jack, as I mentioned earlier, we foresee being able to maintain margins near the 50% level that we did both in the first and the second quarter. And the offsetting items within there are the continued shifts, particularly this year in the second half of the year of the payer mix and revenue, but that also being boosted by our progress that Jon has been talking about in the DTE category. And then also later this year is the consumer category stabilizing. So that's how we see the evolution of gross margin through 2023.

Operator

[Operator Instructions] At this time, there are no further questions. I will now hand the call over to CEO, Jon Cohen.

Jon R. Cohen
CEO & Director

Thank you, and thanks, everybody, for joining us on the call this morning. I want to take the opportunity to again emphasize my continued and our team's continued enthusiasm and confidence in our business' ability to address the growing need for covered mental health services throughout the country. We believe and know that the Talkspace platform, which encompasses our leading brand, comprehensive suite of products and clinical and operational capability is strategically situated to meet this growing demand with high-quality care and to reach profitability in the near term. Thank you again, everyone, and have the great rest of your day.

Operator
This concludes our call. Thank you for joining. You may now disconnect your lines.