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**R1 RCM Inc.** NasdaqGS:RCM

*Earnings Call*

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# Call Participants

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## EXECUTIVES

**Evan Smith**

*Senior Vice President of Finance & Investor Relations*

**Jennifer Williams**

*Executive VP, CFO & Treasurer*

**Lee Rivas**

*CEO & Director*

# Presentation

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## Operator

Thank you for standing by. My name is Eric, and I will be your conference operator today. At this time, I would like to welcome everyone to the Second Quarter 2024 R1 RCM Inc. Earnings Conference Call. [Operator Instructions] I would now like to turn the call over to Evan Smith. Please go ahead.

## Evan Smith

*Senior Vice President of Finance & Investor Relations*

Thank you, operator. Certain statements made during this call may be considered forward-looking statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

In particular, any statements about our future growth plans and performance statements about the impacts of recent cyberattacks, including the Change Healthcare and Ascension cyberattacks on our business and financial results, our strategic and cost-saving initiatives, our liquidity position, our integration, our growth opportunities, our future financial performance are forward-looking statements.

These statements are often identified by the use of words such as anticipate, believe, estimate, intend, design, may, plan, project, would and similar expressions or variations. Investors are cautioned not to place undue reliance on such forward-looking statements. All forward-looking statements made on today's call involve risks and uncertainties.

While we may elect to update these forward-looking statements at some point in the future, we have no current intention of doing so except to the extent required by applicable law.

Our actual results and outcomes may differ materially from those included in these forward-looking statements as a result of various factors, including but not limited to, the completion of the take-private transaction announced on August 1, 2024, on anticipated terms and timing or at all; breaches or failures of our vendors' information security measures or unauthorized access to a customer's data; disruptions in or damages to our global business service centers, third-party operated data centers or other services provided by other third parties; economic downturns and market conditions beyond our control, including high inflation; the quality of global financial markets; our ability to timely and successfully achieve the anticipated benefits and potential synergies of the acquisitions of Cloudmed and Acclara; our ability to retain existing customers or acquire new customers; the development of markets for our revenue cycle management offering; variability in the lead time of prospective customers; delayed or unsuccessful implementation of our technologies, including AI; competition with the market and the factors discussed under the heading Risk Factors in our most recent annual report on Form 10-K.

Certain results will be referenced on this call may be rounded to the nearest whole number. We will also be referencing non-GAAP metrics on this call. For reconciliation of non-GAAP metrics to the most closely comparable GAAP metrics, please refer to our press release.

As a reminder, last week, we announced the execution of the definitive agreement with TowerBrook and CD&R, where the 2 firms will acquire all the outstanding common stock of the company that TowerBrook does not currently own. In light of the pending transaction, we are not providing guidance for 2024 or taking questions following our prepared remarks.

Now let me turn the call over to Lee. Lee, go ahead.

## Lee Rivas

*CEO & Director*

Thank you, Evan, and good morning, everyone. As indicated in our press release, we delivered strong operational results and continue to advance our technology transformation, while addressing the impacts resulting from the cyberattack on one of our largest customers as well as the Change Healthcare outage.

Underlying business trends are positive, resulting in approximately \$628 million in revenue and \$156 million in adjusted EBITDA for the second quarter. Before I provide more detail on our progress in the quarter, I want to reinforce our commitment and belief in our position in a growing industry and our strategy to be the platform of choice for providers.

We operate with the most scale of any technology and service provider in our space. We currently serve over 90 of the top 100 health systems and over 500 customers. The breadth of data we access, the power of our technology platform and our unmatched global scale enables our teams to deliver best-in-class unit economics, increased revenue yields and improved patient satisfaction, which are the main value drivers for our customers.

As evidenced by response to recent events, the company demonstrated its significant operational agility and scale, the ability to drive rapid deployment of high-impact technologies and our close collaborative relationships with our customer organizations. We believe our customer-centric approach and continued innovation around Gen AI will keep R1 at the forefront of the industry and support our continued growth.

Now let me shift to execution on our priorities through the first half of the year. First, operational execution. First, let me cover the onboarding of our largest new end-to-end customer. The customer's leadership team has been very supportive to execute a seamless transition to R1. I am pleased to report that we successfully completed the onboarding of over 1,900 associates over the last several weeks and are on track to begin ramping revenue in the second half of the year.

These team members are continuing to perform outstanding work implementing our technology. We are using an onboarding playbook that has been successful with our other large acute customers, which gives us confidence in our ability to achieve the operational and financial objectives we stated for this contract.

The integration of Acclara continues to progress. We are impressed with the team as we continue to advance opportunities to integrate the business into our existing offerings. We believe we are at or ahead of our integration time line, and we remain confident in our ability to achieve our stated synergy objectives.

While focused on the integration, we also have a disciplined approach to our commercial strategy and are actively meeting with the Acclara customer base, which we believe will provide additional cross-selling opportunities to support our growth going forward.

Last, I want to provide some color surrounding R1's operations related to the Ascension cyberattack announced in early May. Given we are deeply embedded across Ascension's revenue cycle operations, our operating and technology teams mobilized quickly. Our priority from the outset has been patient safety and care continuity, combined with the security of R1 systems.

After disconnecting from the systems, we implemented downtime procedures across all functions during the outage. These manual processes have resulted in hundreds of thousands of paper registrations and corresponding clinical records, which need to be loaded into the electronic systems. We are happy to report that we have reconnected [ PAS ] systems, and we expect to gradually resume normal operations over the coming weeks.

We have brought in additional resources to assist in backlog resolution, including scanning paper documentation, coding outstanding claims and cash posting. These additional costs began in the second quarter and are expected to continue throughout the remainder of the year. We believe our dedicated approach to operational continuity and recover in support of our customers bolsters our position as the leading revenue cycle partner in the industry.

Now let me move to our second priority, growth. We continue to execute on our growth plan, including new modular bookings and expanding new opportunities in our end-to-end pipeline. The end-to-end pipeline consists of a diverse selection of mid- to large-sized health systems who have engaged deeply with our commercial teams to explore partnership opportunities.

In addition to adding to our 500-plus customer base, we continue to have success cross-selling within our core customer base. A notable example this quarter included an expansion with a long-standing transfer DRG validation customer.

During the quarter, we added charge capture and underpayment solutions, which are anticipated to add several million dollars in additional annual revenue. We are also gaining traction with our functional model through successful onboardings, new bookings and continued interest in this solution.

Last quarter, we mentioned an expansion with a \$400 million NPR regional hospital for inpatient clinical denials, and that we were in discussions for additional opportunities, including a managed service or functional partnership deal for our CDI Total Performance solution offering. During the quarter, we expanded this relationship by signing the CDI functional partnership and adding coding and denials management -- modular solutions.

We believe this example demonstrates the long runway for growth within our core base, and we are in discussions to further expand this relationship to include 3 additional modular solutions.

Finally, we are executing on our technology road map. In June, Steve Albert and Brian Gambs, our Chief Product and Chief Technology Officers shared top priorities with investors, which includes further development of our platform, AI and automation as well as new solution innovation. With access to a large-scale data ecosystem, technology remains a cornerstone of our strategy, which we believe will enable R1 to drive down costs, improve revenue yield and enable patient satisfaction.

First, our platform is the foundation for how we are able to drive operational efficiencies and increase user satisfaction for our employee base while also improving customer results. You heard the team discuss our modernization efforts, which started with our cloud migration. We believe these infrastructure improvements allow us to scale with a high degree of reliability, which is increasingly important given our data ecosystem.

Second, our use of advanced technologies, including Generative AI and Intelligent Automation continues to transform many aspects of work performed by our associates. We are focused on AI assistance, AI-infused task automation and enhanced self-service. Last quarter, you heard us discuss our automated clinical appeals application, which assists our clinical experts by reading medical records for clinically denied claims and then drafting an appeal.

This reduced this time spent by our team members by 75% from 1 hour down to 15 minutes. In addition, we continually add task automation to some of the most complex problems in revenue cycles, such as prior auth. We believe this multistep process has the potential to save providers up to \$20 billion annually in the long term by preventing care delays and reducing the time spent for requests.

Lastly, we continue to leverage our data, scale and expertise to develop new products and ways to serve our customers. Recent examples include insurance discovery, modular coding and patient receivable solutions, each of which enables lower cost and expands revenue for our providers. Our commercial team has started discussing these solutions with providers, and we anticipate our results to further assist in future bookings and revenue growth for R1.

In summary, we believe our vision to be the automation platform of choice for the provider industry is clear and achievable. Our strategy to meet providers where they are in their needs today matches a large and growing market, and we expect will help us continue to grow and further diversify our business. Lastly, our value proposition to the provider industry is strong, combining technology, global scale and the best people in the industry.

Thank you. And with that, I'll turn the call over to Jennifer to discuss our quarterly financials.

**Jennifer Williams**

*Executive VP, CFO & Treasurer*

Thank you, Lee, and good morning, everyone. Our second quarter financial results continue to demonstrate the strength of our underlying business and the progress we are making against our financial

objectives. Despite the impact of recent disruptions related to both Change Healthcare and Ascension outages, our underlying business continues to perform ahead of our expectations.

We delivered solid results in the second quarter with revenue of \$627.9 million and adjusted EBITDA of \$156.1 million, demonstrating our continued cost discipline as well as operational and technology-driven initiatives to further enhance our global capabilities and infrastructure.

Total revenue grew by 12% year-over-year, primarily driven by the contribution of Acclara and continued growth in our Modular business. This was partially offset by our previously disclosed customer attrition in our physician customer base and impact of facility divestitures. Net operating fees of \$374.6 million grew approximately 5% or \$16.8 million year-over-year. This was primarily driven by the contribution of Acclara as well as slightly better-than-expected volumes in our enterprise customer base. This was partially offset by the previously mentioned attrition and divestitures.

Incentive fees were \$21.7 million. This was slightly below our expectations, primarily due to a \$4 million impact related to the outages. This incident negatively impacted balance sheet metrics related to cash and A/R measured at the end of the quarter.

Our Modular and Other revenue of \$231.6 million grew by 35% or approximately \$60 million year-over-year, primarily driven by the addition of Acclara revenues as well as continued growth in our Modular business from the expansion of services to existing customers and new customer contracts.

Turning to expenses for the quarter. Non-GAAP cost of services in Q2 was approximately \$421 million, up roughly \$57 million year-over-year, primarily related to the inclusion of Acclara. Excluding the impact of Acclara, cost of services was flat as investments in technology were offset by reductions in operational costs in our Physician business to align to the lower revenue in that business.

Non-GAAP cost of services also included approximately \$4 million of incremental operational expenses incurred in the second quarter to assist with both Ascension and Change Healthcare cyberattacks. Non-GAAP SG&A expenses were \$50.8 million, down approximately \$3 million from the prior year.

Expenses related to the Acclara acquisition were more than offset by lower allowances for credit losses. Other non-GAAP SG&A expenses remained essentially flat year-over-year and compared to the first quarter of the year.

Our adjusted EBITDA for the quarter was \$156.1 million, which was slightly ahead of our internal expectations even after the impact from the incidents we mentioned for the quarter. Our continued focus on cost discipline and operational initiatives to enhance performance across the organization helped mitigate the revenue impact and additional costs related to both Change Healthcare and Ascension cyber events that the industry has experienced this year.

Lastly, we incurred \$34.3 million in Other expenses. This included \$14 million of integration-related costs, including severance related to actions announced with the Acclara integration. Other expenses included \$6.3 million related to a onetime vendor termination fee now that our migration to cloud services is essentially complete. We also incurred approximately \$8 million in advisory fees related to the special committee strategic review process we previously disclosed.

Now let me provide a couple of comments on cash flow and the balance sheet. Cash and cash equivalents at the end of June were \$163 million compared to \$173.6 million at the end of December. For the quarter, we generated \$36.8 million in cash from operations. Net debt at the end of the quarter was \$2.1 billion and includes a paydown of the \$75 million in revolver that we borrowed in early April related to the Change Healthcare incident. Our liquidity continues to remain strong with approximately \$682 million at the end of June, both from cash on our balance sheet and borrowing capacity on our revolver.

In light of the transaction announced last week and as Evan also mentioned earlier, we will not be providing guidance for 2024. However, I do want to provide some color on our expectations for the second half of the year related to the impact of the Ascension cybersecurity incident. We expect the full year revenue impact of the Ascension outage to be between \$75 million to \$95 million. Most of this impact is expected to be a delay in timing of revenue from the second half of 2024 into the first half of 2025.

The majority of the impact will be seen in our net operating fees or base fees based on timing of cash collections.

As a reminder, our base fees lag the timing of cash collections. So any cash collected by Ascension after August will be recovered in our 2025 net operating fees. Although less material, we also expect some impact to our modular and other fee revenue as Ascension does contract for some of our modular solutions and was unable to transmit volumes to our platform during their outage.

We will also see an increase in expenses related to the Ascension outage. We expect to incur \$10 million to \$15 million in incremental cost in the second half of the year. We expect this will mostly be driven by overtime and incremental labor as we have added several hundred onshore contractors on-site across many facilities of Ascension to assist in the backlog of paperwork created from manual processing. This effort is critical to recover the backlog of claims accumulated during the outage.

Through our large network of third-party partners, we were able to assist in rapid deployment of talent to locations in need of help. This is a testament to our scale and ability to serve our customers. We also expect to incur some technology costs to ensure all systems are fully recovered, secure and operating effectively.

While the impact of the Ascension outage will create a significant impact on our near-term financials in the second half of 2024, we do not expect that the outage will create a long-term impact to the core operations and results of our business. We believe that most of the recovery will occur in 2025 and that the business will return to normal cash collection cycles over the course of the 2025 calendar year.

Ascension plays an important part of U.S. health care and is R1's largest customer. We are committed to partnering with them through their recovery efforts to ensure they are able to continue to serve patients across all of their care settings. Our employees have worked tirelessly around the clock over the last few months to support Ascension through both the outage and the recovery process.

I'm incredibly proud of the work we have done, and I want to personally thank our over 33,000 global employees for remaining focused on serving our customers. In closing, we had a good quarter, and we're very pleased with the work we are doing on behalf of our customers.

The customer and vendor cyber events this year have proven the value that we provide to the health care industry. Providers need our services, scale and technology more than ever, and we remain focused on the opportunities in front of us. We look forward to continuing to deliver excellent results to our customers throughout the remainder of the year.

Thank you, everyone, for joining. Operator, I will now turn the call back over to you.

**Operator**

Ladies and gentlemen, that concludes today's call. Thank you all for joining, and you may now disconnect.

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