1Q19 Earnings Call

Peter Kuipers:

Good afternoon and welcome to the Omnicell first quarter 2019 earnings call. Joining me today is Randall Lipps, Omnicell Founder, Chairman, President, and CEO.

This call will include forward-looking statements subject to risks, uncertainties and other factors that could cause actual results to differ materially from those expressed or implied. For a more detailed description of the risks that impact these forward-looking statements, please refer to the information in our press release today, in the Omnicell annual report on Form 10-K filed with the SEC on February 27, 2019, and in other more recent reports filed with the SEC. Please be aware that you should not place undue reliance on any forward-looking statements made today.

The date of this conference call is April 25th, 2019, and all forward-looking statements made on this call are made based on the beliefs of Omnicell as of this date only. Future events or simply the passage of time may cause these beliefs to change. Finally, this conference call is the property of Omnicell, Inc., and any taping, other duplication or rebroadcast without the express written consent of Omnicell is prohibited.

Randall will first provide an update on our business. After Randall's remarks, I will cover our results for the first quarter of 2019 and our guidance for the remainder of the year. Our first quarter financial results are included in our earnings announcement which was released earlier today and is posted in the "Investor Relations" section of our website at omnicell.com. Our prepared remarks will also be posted in this same section.

Let me now turn over the call to Randall.

Randall Lipps:

Good afternoon everyone! I am extremely pleased with our performance and the execution of our strategy as we continue to transition the business towards delivering on our vision of the autonomous pharmacy. Some of the key financial accomplishments during the quarter include:

1. Revenue of $203 Million, up 11% from Q1 2018
2. Non-GAAP Earnings Per Share of $0.61, up 110% from Q1 2018
3. Non-GAAP Operating Margin of 13%, up 500 basis points from Q1 2018

As previously announced late last year, our vision of the Autonomous Pharmacy integrates a comprehensive set of solutions powered by the Omnicell Cloud Data Platform across three key areas: 1. Automation solutions designed to digitize and streamline workflows; 2. Intelligence that provides actionable insights to better understand medication usage and improve pharmacy supply chain management; and 3. Enhancing medication dispensing workflows through expert services that serve as an extension of pharmacy operations to support improved efficiency, regulatory compliance, and patient outcomes. The Autonomous Pharmacy vision is driven by core products such as: our XR2 Central Pharmacy robotic dispensing system, which is designed to provide automated medication dispensing with virtually zero errors. This system reduces labor costs, decreases medication waste and improves patient safety by helping to ensure each patient receives the right medication at the right time. Our IV technology has been shown to reduce medication compounding costs by 66% compared to outsourcing alternatives. Finally, the Omnicell Patient Engagement platform provides the pharmacy with a holistic view of patients, not only by organizing prescriptions, but by identifying, preparing, and documenting ongoing patient engagement that drives revenue and promotes medication adherence.

During the first quarter of 2019, we continued to see strong momentum in new orders booked which included multiple products from the Omnicell Autonomous Pharmacy platform. During the first quarter we signed several sole source agreements with healthcare organizations that are expected to implement and expand the utilization of our solutions for years to come. In addition, we gained further momentum with new customer wins in Q1-19. Some notable examples of customers integrating our Autonomous Pharmacy solutions include:

Inova Healthcare, Northern Virginia's leading nonprofit healthcare provider, serving more than 2 million individuals annually, is expanding its current automation footprint with the addition of Omnicell's Robotic IV Insourcing Solution (RIIS), a unique program that combines advanced robotic technology, data and expertly trained pharmacy technician staff into a comprehensive, turnkey package that provides a streamlined path for hospitals to insource their sterile compounding. On patient floors, Inova will implement Omnicell's XT Series automated medication dispensing systems, which help improve workflow efficiency, medication accountability, and patient safety.

CaroMont Health, one of the leading regional healthcare providers in North Carolina, has selected Omnicell's comprehensive, industry-leading medication management platform to help enhance financial performance and operational efficiency. This includes leveraging Performance Center to better track medication inventory and usage, as well as the addition of IVX workflow automation to support sterile compounding, and XT Series automated dispensing systems to help improve patient care on nursing floors.

The University of Tennessee Medical Center in Knoxville has extended their partnership with Omnicell, upgrading their medication and supply dispensing systems to the XT Series. The University of Tennessee will also be using Omnicell's Central Pharmacy Manager to streamline their medication processes from the time a medication is received from the wholesaler, to the time a medication is dispensed to a patient or medication dispensing system. Central Pharmacy Manager helps improve visibility to inventory and usage, so it can help improve patient care on nursing floors by ensuring availability of medications.

We are thrilled to partner with these organizations.

Our results in the first quarter continue to demonstrate that our strategy is working well and we look forward to continuing our progression through the remainder of the year.

I will now hand over the call to Peter to discuss the first quarter financial results as well as the guidance for the rest of 2019.

Peter Kuipers:
Thank you Randall.

Our first quarter 2019 GAAP revenue of $203 million was up 11% over the first quarter of 2018. The increase in revenue was largely due to:

1. An increase in XT Series implementations from a growing base of customers.
2. Increases in annual service and maintenance revenue from a larger installed base of equipment, and
3. Contributions from new product sales such as XR2 and IVX Workflow that are ramping since we launched the products during 2018.

The first quarter Earnings per share in accordance with GAAP was $0.08, up from $0.07 per share in the first quarter of 2018. The increase in earnings per share is largely due to profit from higher revenue which was partially offset by higher income tax expense compared to Q1-18.

In addition to GAAP financial results, we report our results on a Non-GAAP basis which excludes stock compensation expense, amortization of intangible assets associated with acquisitions, one time acquisition and restructuring related expenses, tax reform and restructuring income tax benefits and expenses, contingent gains and amortization of debt issuance costs. We use Non-GAAP financial statements in addition to GAAP financial statements because we believe it is useful for investors to understand the amortization of acquisition-related costs and non-cash stock compensation expenses that are a component of our reported results, as well as one-time events and one-time acquisition and restructuring-related expenses. A full reconciliation of our GAAP to Non-GAAP results is included in our first quarter earnings press release and is posted on our website.

For the first quarter of 2019, Non-GAAP revenue was $203 million, which is an 11% increase over the first quarter of 2018.

First quarter 2019 Non-GAAP EPS was $0.61 per share, up 110% from the same quarter last year. I'd like to take a moment to explain several factors that affected our Q1-19 Non-GAAP EPS compared to our guidance. Our Non-GAAP EPS of $0.61 in the first quarter of 2019 exceeded the mid-point of our guidance range by approximately $0.20 per share. The majority of the increase was driven by several operational and non-operational factors:

1. First, our revenue exceeded the mid-point of our guidance range by approximately $4 million. The incremental profit contribution from this additional revenue contributed approximately $0.03 per share of benefit in the quarter.
2. Second, we experienced lower manufacturing and lower operating expenses than expected during Q1-19, which drove approximately $0.09 of benefit during the quarter.

The higher revenue combined with lower cost of goods sold and lower operating expenses resulted in a Non-GAAP operating margin of 13% for the quarter which was above our expectations.

3. Lastly, below operating margin, or non-operational, we recorded a benefit of $0.07 per share related to tax benefits realized from the exercise of employee stock options. During the first quarter of 2019 our stock price increased significantly and as a result employee stock options were exercised at a higher rate than we expected. From a tax perspective the company is entitled to take a tax deduction for the difference between the exercise price and the fair value of the grant and as a result, our effective income tax rate was lower than we anticipated.

Non-GAAP other expenses for the first quarter of 2019 was $800 thousand of expense compared to $1.7 million in Q4-18. The decrease primarily relates to lower interest expense as we have continued to use excess cash to deleverage and also the impact of foreign currency re-measurement.

Beginning in 2019 we no longer report our business in segments. Previously we reported our business in two segments. Our previous segments were:

1. Automation and Analytics, which primarily consisted of automation equipment and services provided to hospitals and health systems. And
2. Medication Adherence, which primarily provided automation and packaging solutions to institutional, retail and payer organizations.

Beginning in 2019 we now report our business as one segment due to the following factors:

1. First, as our business continues to evolve with the vision for the Autonomous Pharmacy, we have made organizational changes to better serve our customers. With the previously announced company-wide realignment, including realignment of our field and sales organizations, we are now structured to play a more consultative role, helping our customers to achieve performance goals today, while offering strategic support to drive improved clinical and financial goals over the long term.
2. Second, throughout 2018 we began a platform oriented sales model whereby we often sell multiple product offerings to our customers. We have found that many of our customers purchase multiple products from our platform. Our platform strategy has made it increasingly more difficult to bifurcate our business.
3. Third, as consolidation within our customer base has continued to occur, it has also become more difficult to manage our business in multiple segments.
4. Lastly, our operating model and strategic decision making are focused on one strategic direction for the Autonomous Pharmacy vision to serve all of our customers collectively.

Let’s now move to the balance sheet and cash flow.

First quarter 2019 cash flow from operations was $26 million. Our operating cash flow in the first quarter was primarily driven by net income and adjustments for non-cash related items such as depreciation and amortization. During the first quarter of 2019 the Company generated approximately $10 million of free cash flow. We believe our business will continue to deliver free cash flow through the remainder of 2019.

Inventories at March 31, 2019 were approximately $104 million, a sequential increase of approximately $3 million. The increase is driven primarily by additional raw materials needed to meet demand as we continue to grow.

Accounts receivable days sales outstanding for the first quarter were 93 days, down 4 days from the first quarter of 2018. The decrease was mostly driven by strong collections.

At March 31, 2019 our cash balance was $77 million, up $10 million sequentially. The increase in cash is due to proceeds from our At The Market offering and operating cash flows. During the first quarter we utilized our At The Market offering to sell approximately 243 thousand shares of our common stock at an average selling price of $84.98 per share. The total gross proceeds raised during the quarter was approximately $21 million. These proceeds were used primarily to repay outstanding debt. During the first quarter we repaid $39 million of debt. As of March 31, 2019 we had $101 million of outstanding funded debt and our loan leverage measured as outstanding total funded loan balance over the Last Twelve Months (LTM) of bank EBITDA was approximately 0.7 times.

Our headcount was 2,472 at March 31, 2019, down 4 from the end of 2018. The decrease relates to our sales force realignment mentioned earlier partially offset by new employees hired into other areas of our business.

Moving to our full year 2019 guidance:

- All Product Bookings and Revenue guidance is unchanged from the guidance previously provided on our Q4-18 earnings call.
- We expect 2019 Product Bookings to be between $745 and $780 million.
- We expect 2019 Total Revenue to be between $880 and $900 million.
- We expect 2019 Product Revenue to be between $652 and $668 million.
- We expect 2019 Service Revenue to be between $228 and $232 million.
- We are increasing our total year 2019 Non-GAAP EPS.

- Our previous total year 2019 Non-GAAP EPS guidance was between $2.40 and $2.60 per share. We now expect our total year 2019 Non-GAAP EPS guidance to be between $2.62 and $2.82 per share.
- We expect our Non-GAAP operating margins for the full year to approach 15%, consistent with our long-term financial framework.

For the second quarter of 2019:

- We expect Total Revenue to be between $211 and $217 million.
- We expect Product Revenue to be between $153 and $158 million.
- We expect Service Revenue to be between $58 and $59 million.
- We expect Non-GAAP EPS to be between $0.61 and $0.66 per share.

Finally, for 2019 we are now assuming an average effective tax rate of 7% in our Non-GAAP EPS guidance range.

As Randall mentioned we are very pleased with the results for the first quarter of 2019 and we look forward to continuing to deliver strong and profitable results throughout the rest of the year.

Now we would like to open the call for your questions.

Randall Lipps

Always good to start the year off with a great start. It's clear that the Omnicell platform is winning and that the company is scaling successfully. Our solutions are driving improvement in patient and provider outcomes in a variety of healthcare settings across the continuum of care, with medication management automation becoming central to their success. I would like to thank our customers, our employees, and our shareholders for partnering with us as we deliver our vision of the autonomous pharmacy and improve healthcare for everyone!

Thank you everyone!

Omnicell, Inc.
Condensed Consolidated Statements of Operations
(Unaudited, in thousands, except per share data)

	Three months ended March 31,	
	2019	2018 [(a)]
Revenues:		
Product revenues	$ 145,610	$ 130,659
Services and other revenues	56,907	51,960
Total revenues	202,517	182,619
Cost of revenues:		
Cost of product revenues	78,811	75,417
Cost of services and other revenues	26,589	24,747
Total cost of revenues	105,400	100,164
Gross profit	97,117	82,455
Operating expenses:		
Research and development	16,078	16,537
Selling, general, and administrative	68,278	65,285
Total operating expenses	84,356	81,822
Income from operations	12,761	633
Interest and other income (expense), net	(1,410)	(2,729)
Income (loss) before provision for income taxes	11,351	(2,096)
Provision for (benefit from) income taxes	8,067	(4,816)
Net income	$ 3,284	$ 2,720
Net income per share:		
Basic	$ 0.08	$ 0.07
Diluted	$ 0.08	$ 0.07
Weighted-average shares outstanding:		
Basic	40,692	38,635
Diluted	42,281	39,691

(a) Includes a $0.6 million reclassification from services and other revenues to product revenues to conform with current-period presentation.

Omnicell, Inc.
Condensed Consolidated Balance Sheets
(Unaudited, in thousands)

	March 31, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 77,244	$ 67,192
Accounts receivable and unbilled receivables, net	203,489	196,238
Inventories	103,909	100,868
Prepaid expenses	17,048	20,700
Other current assets	12,017	12,136
Total current assets	413,707	397,134
Property and equipment, net	52,039	51,500
Long-term investment in sales-type leases, net	19,469	17,082
Operating lease right-of-use assets	63,851	—
Goodwill	336,119	335,887
Intangible assets, net	138,893	143,686
Long-term deferred tax assets	32,043	15,197
Prepaid commissions	43,669	46,143
Other long-term assets	77,270	74,613
Total assets	$ 1,177,060	$ 1,081,242
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 38,466	$ 38,038
Accrued compensation	29,056	41,660
Accrued liabilities	52,996	43,047
Deferred revenues, net	90,104	81,835
Total current liabilities	210,622	204,580
Long-term deferred revenues	10,302	10,582
Long-term deferred tax liabilities	61,405	41,484
Long-term operating lease liabilities	57,470	—
Other long-term liabilities	9,786	9,562
Long-term debt, net	96,990	135,417
Total liabilities	446,575	401,625
Total stockholders' equity	730,485	679,617
Total liabilities and stockholders' equity	$ 1,177,060	$ 1,081,242

Omnicell, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited, in thousands)

	Three months ended March 31, 2019	Three months ended March 31, 2018
Operating Activities		
Net income	$ 3,284	$ 2,720
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	12,637	12,310
Loss on disposal of fixed assets	355	—
Share-based compensation expense	8,410	6,528
Deferred income taxes	3,075	(5,128)
Amortization of operating lease right-of-use assets	2,602	—
Amortization of debt financing fees	573	573
Changes in operating assets and liabilities:		
Accounts receivable and unbilled receivables	(7,251)	(632)
Inventories	(2,936)	(6,881)
Prepaid expenses	3,652	(769)
Other current assets	373	(997)
Investment in sales-type leases	(2,641)	(1,491)
Prepaid commissions	2,474	1,796
Other long-term assets	5,206	(1,673)
Accounts payable	(233)	(9,416)
Accrued compensation	(12,604)	2,391
Accrued liabilities	127	4,276
Deferred revenues	7,989	15,118
Operating lease liabilities	(2,669)	—
Other long-term liabilities	4,074	131
Net cash provided by operating activities	26,497	18,856
Investing Activities		
Software development for external use	(11,717)	(5,272)
Purchases of property and equipment	(4,980)	(9,268)
Net cash used in investing activities	(16,697)	(14,540)
Financing Activities		
Repayment of debt and revolving credit facility	(39,000)	(2,500)
At the market offering, net of offering costs	20,216	—
Proceeds from issuances under stock-based compensation plans	20,526	9,541
Employees' taxes paid related to restricted stock units	(1,920)	(1,300)
Net cash provided by (used in) financing activities	(178)	5,741
Effect of exchange rate changes on cash and cash equivalents	430	1,292
Net increase in cash and cash equivalents	10,052	11,349
Cash and cash equivalents at beginning of period	67,192	32,424
Cash and cash equivalents at end of period	$ 77,244	$ 43,773

Omnicell, Inc.
Reconciliation of GAAP to Non-GAAP
(Unaudited, in thousands, except per share data and percentage)

	Three months ended	
	March 31, 2019	March 31, 2018
Reconciliation of GAAP revenues to non-GAAP revenues:		
GAAP revenues	$ 202,517	$ 182,619
Non-GAAP revenues	$ 202,517	$ 182,619
Reconciliation of GAAP gross profit to non-GAAP gross profit:		
GAAP gross profit	$ 97,117	$ 82,455
GAAP gross margin	*48.0%*	*45.2%*
Share-based compensation expense	1,462	1,019
Amortization of acquired intangibles	2,066	2,791
Non-GAAP gross profit	$ 100,645	$ 86,265
Non-GAAP gross margin	*49.7%*	*47.2%*
Reconciliation of GAAP operating expenses to non-GAAP operating expenses:		
GAAP operating expenses	$ 84,356	$ 81,822
GAAP operating expenses % to total revenues	*41.7%*	*44.8%*
Share-based compensation expense	(6,948)	(5,509)
Amortization of acquired intangibles	(2,716)	(3,238)
Severance and other expenses	(286)	(1,512)
Non-GAAP operating expenses	$ 74,406	$ 71,563
Non-GAAP operating expenses % to total non-GAAP revenues	*36.7%*	*39.2%*
Reconciliation of GAAP income from operations to non-GAAP income from operations:		
GAAP income from operations	$ 12,761	$ 633
GAAP operating income % to total revenues	*6.3%*	*0.3%*
Share-based compensation expense	8,410	6,528
Amortization of acquired intangibles	4,782	6,029
Severance and other expenses	286	1,512
Non-GAAP income from operations	$ 26,239	$ 14,702
Non-GAAP operating income % to total non-GAAP revenues	*13.0%*	*8.1%*

Omnicell, Inc.
Reconciliation of GAAP to Non-GAAP
(Unaudited, in thousands, except per share data and percentage)

	Three months ended	
	March 31, 2019	March 31, 2018
Reconciliation of GAAP net income to non-GAAP net income:		
GAAP net income	$ 3,284	$ 2,720
Tax benefit for restructuring activity	—	(4,205)
Tax impact of IP restructuring	9,624	—
Share-based compensation expense	8,410	6,528
Amortization of acquired intangibles	4,782	6,029
Severance and other expenses[a]	859	2,085
Tax effect of the adjustments above[b]	(1,184)	(1,703)
Non-GAAP net income	$ 25,775	$ 11,454
Reconciliation of GAAP net income per share - diluted to non-GAAP net income per share - diluted:		
Shares - diluted GAAP	42,281	39,691
Shares - diluted Non-GAAP	42,281	39,691
GAAP net income per share - diluted	$ 0.08	$ 0.07
Tax benefit for restructuring activity	—	(0.10)
Tax impact of IP restructuring	0.23	—
Share-based compensation expense	0.20	0.16
Amortization of acquired intangibles	0.11	0.15
Severance and other expenses	0.02	0.05
Tax effect of the adjustments above[b]	(0.03)	(0.04)
Non-GAAP net income per share - diluted	$ 0.61	$ 0.29
Reconciliation of GAAP net income to non-GAAP Adjusted EBITDA[c]:		
GAAP net income	$ 3,284	$ 2,720
Share-based compensation expense	8,410	6,528
Interest (income) and expense, net	706	1,772
Depreciation and amortization expense	12,637	12,310
Severance and other expenses	859	2,085
Income tax expense (benefit)	8,067	(4,816)
Non-GAAP adjusted EBITDA	$ 33,963	$ 20,599

(a) For the three months ended March 31, 2019, other expenses include $0.4 million and $0.2 million of amortization of debt issuance costs related to prior acquisitions and credit facilities amendments, respectively, and $0.3 million of IP restructuring costs. For the three months ended March 31, 2018, other expenses include $0.4 million and $0.2 million of amortization of debt issuance costs related to prior acquisitions and credit facilities amendments, respectively.

(b) Tax effects calculated for all adjustments except tax benefits and expenses, and share-based compensation expense, using an estimated annual effective tax rate of 21% for both fiscal years 2019 and 2018.

(c) Defined as earnings before interest income and expense, taxes, depreciation and amortization, share-based compensation, as well as excluding certain non-GAAP adjustments.