4Q18 Earnings Call

Peter Kuipers:

Good afternoon and welcome to the Omnicell fourth quarter and year end 2018 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, 2018, 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 February 7th, 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 2018 and our guidance for 2019. Our fourth 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. Included in our fourth quarter earnings release are a few slides that Randall will speak to in his section. 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! We just concluded our global sales field meeting. 2018 was a record year for Omnicell. I'm very pleased with the execution of our strategy and the performance of the business as we continue to transition our business towards the vision for the autonomous pharmacy. Some of the key financial accomplishments during the year include:

1. Record product bookings of $716 Million, up 26% from 2017
2. Record product backlog of $478 Million, up 39% from 2017
3. Record revenue of $787 Million, up 10% from 2017
4. Record Non-GAAP Earnings Per Share of $2.09, up 48% from 2017

In addition to these financial results, I am also very proud of the Omnicell team for the work done to execute on our strategy. During 2018 we released several new products. The most notable additions to our product portfolio are the XR2 Central Pharmacy Robot and the IVX Workflow. These two products further expand our core capabilities in automating the flow of medications through the hospital. In addition, we expanded our population health product offerings by introducing new capabilities in our patient engagement platform and began to develop relationships with Payers to use these solutions to provide improved patient care. We have also continued to make investments in our industry leading medication dispensing technology. Earlier this week our automated dispensing cabinet technology was awarded best in KLAS for the 13th consecutive year and our IV automation was recognized as a category leader for IV compounding solutions. As a result of our continued innovation, we believe Omnicell has become an even greater strategic partner for health systems, but we have more work to do.

Late last year at the ASHP Midyear Clinical Meeting, we announced our vision for the Autonomous Pharmacy. Earlier this year we also presented our vision at the J.P. Morgan Healthcare Conference and I wanted to take a moment to explain this in more detail. Included in our fourth quarter earnings release are a few slides to help visualize the issues facing healthcare and our strategy to assist with a solution.

Slide #2 shows the rapid increase in Healthcare administrators since 1970. As you can see, the number of administrators has increased 3,000% over this time. Over time the complexities in medication management have led health systems to address the increased volume of patients and medications with very manual processes. These processes are not efficient and have resulted in substantial growth in the number of people allocated to administrative tasks to handle the volume. These trends are not sustainable into the future and we believe the key to solving this is with automation tools that integrate together and track medication and therapy to provide the best patient care for the lowest cost.

Moving to slide #3, there are many areas of inefficiency within healthcare that we are working to address. Currently 76% of a pharmacist's activities are non-clinical. Today over $450 Billion is spent on drug spend annually in the U.S. with sub-optimal outcomes for patients. We believe that our core product offerings have the ability to address many of these areas through improved automation that we are calling the Autonomous Pharmacy. As you can see, products like our XR2 Central Pharmacy robot 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 manual compounding methods. Finally, our medication adherence solutions provide a way for patients to organize all of their medications in a simple to use consumable package which increases adherence rates to approximately 90%. These are a number of the core products that are the foundation for the Autonomous Pharmacy.

On slide #4, our vision for 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. Automation of medication dispensing **work**flows, which includes expert services that serve as an extension of pharmacy operations to support improved efficiency, regulatory compliance, and patient outcomes.

The right side of the slide shows the areas where our customers are realizing benefits - cost, revenue, safety, efficiency, compliance and value based care. Our vision for the Autonomous Pharmacy seeks to digitize each medication as a node on the network allowing a fully automated flow from pharmacy to patient throughout the continuum of care.

Finally, slide #5 speaks to main trends we see occurring in the industry and these trends align well with our strategy.

- First, healthcare systems continue to consolidate and vertically integrate and they need medication management automation solutions on one platform to improve patient and financial outcomes for both inpatient and outpatient settings
- Secondly, pharmacy spend is the fastest growing spend category in healthcare, and as healthcare organizations increasingly manage the total cost of care, medication management across the care continuum elevates its strategic importance
- Lastly, substantial increases in healthcare administration focused on manual tasks, highlights the need for more complete medication management solutions to drive efficiencies and patient safety.

We believe that our industry-leading medication management platform across the continuum of care and our vision for the future of medication management automation very strongly aligns with these healthcare trends and this has become increasingly evident in many of our platform sales to both new and existing customers.

In the fourth quarter of 2018, we continued to see strong momentum in new orders booked which included multiple products from the Omnicell platform. Overall we see specific strength in customers expanding their implementation of the Omnicell platform by adding additional products and while also upgrading existing products. Some notable examples include:

Texas Children's Hospital

We continue to build on our partnership with Texas Children's Hospital, with the addition of new automation for pharmacy, including the XR2 automated system and IV compounding solutions, as well as an expansion of the XT cabinet footprint. After leveraging Omnicell solutions in other areas of the hospital, these new additions to their autonomous medication management strategy will help bolster patient care and support the safest processes possible.

Vanderbilt University Medical Center

Vanderbilt University Medical Center, one of the largest academic medical centers in the Southeast and a current Omnicell customer, has chosen to upgrade their existing cabinets to the XT Series Automated Dispensing Cabinets. With more than 2 million patient visits each year, closed-loop interoperability with Epic will help Vanderbilt achieve the highest levels of medication safety and security.

California Department of Corrections and Rehabilitation

The California Department of Corrections and Rehabilitation (CDCR) has long ensured that California's patient-inmates receive the medications they need with the help of Omnicell's single-dose packaging solutions. CDCR is now expanding this partnership to pioneer a state-budgeted "Clinic Model," leveraging the XT Series platform at each of their 34 institutions statewide to automate their medication pass process. This effort will increase clinical quality and safety for the 150,000 inmates in the California state corrections system, ultimately reducing costs for California's tax payers.

2018 was a great year for our business. Our new strategy is resonating with customers in the form of record product bookings and we look forward to continuing our progress in 2019.

I will now hand over the call to Peter to discuss the fourth quarter and full year 2018 financial results as well as the guidance for 2019.

Peter Kuipers:

Thank you Randall.

Our fourth quarter 2018 GAAP revenue of $212 million was up 8% year over year. Our full year 2018 GAAP revenue of $787 million was up 10% year over year. The increases in revenue were largely due to an increase in XT Series implementations, increases in annual service and maintenance revenue from a larger installed base of equipment, and contributions from new product sales such as XR2 and IVX Workflow that are ramping since we launched the products during 2018.

The fourth quarter Earnings per share in accordance with GAAP was $0.36, down from $0.79 per share in the fourth quarter of 2017. The decrease in earnings per share is largely due to a one-time tax benefit in Q4-17 which did not repeat in 2018. Our full year 2018 Earnings per share in accordance with GAAP was $0.93, up from $0.79 per share in 2017. Growth in full year earnings per share was driven by the incremental profit contribution from increased sales and overall margin expansion.

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, the acquisition accounting impacts related to deferred revenue fair value adjustments, and the tax reform benefit impact from the Tax Cuts and Jobs Act of 2017. 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 fourth quarter earnings press release and is posted on our website.

For the fourth quarter of 2018, Non-GAAP revenue was $212 million, which is an 8% increase over the fourth quarter of 2017. Our full year 2018 Non-GAAP revenue of $787 million was up 10% year over year.

Fourth quarter 2018 Non-GAAP EPS was $0.70, up 27% from the same quarter last year. Full year 2018 Non-GAAP EPS was $2.09 per share and is up 48% from 2017. The Non-GAAP EPS favorability was mostly driven by higher revenues, gross margin expansion and improved operating leverage.

In addition to strong revenue and profitability growth there are additional indicators that demonstrate the momentum in our business:

1) First, product bookings for the full year 2018 increased approximately 26% to $716 Million. This was a record for the business and exceeded the mid-point of our guidance range by approximately $59 Million. Of the increase above the mid-point of our guidance range approximately $20 million was driven by timing of orders we expected to occur in 2019 but closed earlier in 2018, $20 million was the result of stronger momentum in the business and $19 million was related to one specific platform customer.
2) Second, product backlog as of December 31, 2018 increased approximately 39% to $478 Million.
3) Third, Non-GAAP Gross margins exceeded 50% for the second consecutive quarter and expanded over 200 basis points to 49.3% for the full year 2018.
4) Fourth, our Non-GAAP operating margin exceeded 16% in the fourth quarter and expanded 370 basis points to 12.9% for the full year 2018.
5) Lastly, during the fourth quarter we again entered into a record number of multi-million dollar commercial agreements. Over 90% of these multi-million dollar product bookings are with customers adopting multiple products on the Omnicell Platform.

I'd like to take a moment and explain certain trends in our product backlog as it will be useful to investors in understanding some of the dynamics related to our platform sales approach. Historically, our product backlog has largely consisted of capital equipment that would generally be installed in less than one year, but as our business has evolved to more platform-oriented sales a portion of our product backlog is now longer term in nature. Products like Performance Center and IV RIIS (which is our IV compounding solution as a service) consist of multi-year agreements with customers. These product lines are becoming more substantial to our business and as we continue to transition to more cloud based platform applications it will be more important to understand the impact on our product backlog and revenue. Going forward we will be reporting two different metrics on our product backlog that we believe will be useful to investors. We will report our total product backlog as well as the portion of our product backlog that will not convert to revenue for over one year. As of the end of 2018 our total product backlog as mentioned previously was $478 Million, compared to $345 Million as of the end of 2017. Of these amounts $103 Million and $65 Million as of the end of 2018 and 2017, respectively are considered long-term over one year. We expect to continue to provide these metrics annually.

Our business is also reported in segments, consisting of Automation and Analytics and Medication Adherence. Automation and Analytics consists of our XT and OmniRX automated dispensing cabinets, Anesthesia Workstations, Central Pharmacy, Omnicell Supply, Omnicell Analytics, Performance Center, and Mach4 Robotic Dispensing Systems. Our acquisitions of Avantec, MACH4, Aesynt, and inPharmics are also included in this segment. The Medication Adherence segment consists of a broad platform of subscription software, medication packaging, and equipment used by pharmacists to create adherence packages that assist retail pharmacies in helping patients stay adherent to their medication regimens. Our acquisitions of MTS Medication Technologies, Surgichem, and Ateb are included in the Medication Adherence segment. We report certain corporate expenses that cannot be easily applied to either segment separately.

On a segment basis, our Automation and Analytics segment contributed $178 million in GAAP revenue in the fourth quarter of 2018, up from $162 million in the fourth quarter of 2017. GAAP operating income of $47 million in the fourth quarter of 2018 compares to $37 million of GAAP operating income in the same quarter last year. Non-GAAP operating income of $55 million for the fourth quarter 2018 compares to $44 million of Non-GAAP operating income in the same quarter last year. On a year-to-date basis, GAAP revenue for the full year 2018 was $656 million, up from $587 million in the prior year. GAAP operating income for 2018 was $148 million compared to $94 million in the prior year.

The Medication Adherence segment contributed $34 million in GAAP revenue in the fourth quarter of 2018, down from $35 million in the fourth quarter of 2017. The slight decrease relates to the timing of implementations on certain larger automation equipment. GAAP operating loss of $0.6 million in the fourth quarter of 2018 compares to $0.6 million of GAAP operating profit in the same quarter last year. Non-GAAP operating profit of $1.9 million for the fourth quarter 2018 compares to $3.1 million of Non-GAAP operating income in the same quarter last year. The year over year variance for both GAAP and Non-GAAP operating income was mostly driven by a one-time Excess & Obsolete reserve for slower moving inventory as discussed in the third quarter 2018 earnings call. For the full year GAAP revenue for 2018 was $132 million, up from $126 million in the prior year. GAAP operating loss for 2018 was $5.5 million compared to $1.6 million in the prior year.

Non-GAAP common expenses were $23 million in the fourth quarter of 2018, up from $19 million in 2017. This increase is primarily driven by accruals for product bookings incentives in 2018 that did not occur in 2017.

Non-GAAP other expenses for the fourth quarter of 2018 was $1.7 million primarily consisting of interest expense on the outstanding loan balance and the impact of foreign currency re-measurement.

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

Fourth quarter and full year 2018 cash flow from operations was $48 million and $104 million, respectively. Our strong operating cash flow in the fourth quarter was primarily driven by net income, improvements in working capital and adjustments for non-cash related items such as depreciation and amortization. For the full year the business generated approximately $50 million of free cash flow. We believe our business will continue to deliver free cash flow growth in 2019.

Inventories at December 31, 2018 were approximately $100 million, and relatively flat from the prior quarter and up 5% from last year as we ramped production of XT, XR2 and IVX Workflow.

Accounts receivable days sales outstanding for the fourth quarter were 85, down 8 days from the third quarter in 2018. The decrease was mostly driven by improved collections during the quarter.

At December 31, 2018 our cash balance was $67 million compared to $44 million at September 30, 2018.

As of December 31, 2018 we had $140 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 1.1. In addition, during the fourth quarter we utilized our At The Market offering to sell approximately 557 thousand shares of our common stock at an average selling price of $72.40 per share. The total gross proceeds raised during the quarter was approximately $40 million. These proceeds were used to repay outstanding debt. During the fourth quarter we repaid $50 million of debt. During 2018 we reduced our outstanding debt by 35%.

Our headcount was 2,476 at December 31, 2018, up 129 from the beginning of the year.

Moving to our full year 2019 guidance:

- We expect 2019 Product Bookings to be between $745 and $780 million. This represents a 7% organic growth rate when taking the mid-point of the guidance range. Earlier I mentioned that we received approximately $20 million of product bookings in Q4-18 that we originally expected to occur in Q1-19. When adjusting for the timing of these product bookings, the calculated organic growth rate in our guidance would be 13%. We see strong growth in Product Bookings over the years as both adoption of the Omnicell platform and upgrade cycles are gaining momentum. The Product Bookings CAGR from 2016 to 2019 using the mid-point of the provided guidance is 12%.

- We expect 2019 Total Revenue to be between $880 and $900 million. This represents a 13% organic growth rate when taking the mid-point of the guidance range.
- It's important to note that our total revenue consists of product and service revenue which inherently have different growth rates. As a result, we are providing specific guidance for both product and service revenue in 2019.
- 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 expect total year 2019 Non-GAAP EPS to be between $2.40 and $2.60 per share. This represents a 20% year over year organic growth rate when taking the mid-point of the guidance range.

For the first quarter of 2019:

- We expect Total Revenue to be between $196 and $202 million
- We expect Product Revenue to be between $140 and $145 million
- We expect Service Revenue to be between $56 and $57 million
- We expect Non-GAAP EPS to be between $0.38 and $0.43

Finally, for 2019 we are assuming an average annual effective tax rate of 10% in our Non-GAAP EPS guidance range.

As Randall mentioned we are very pleased with the results for 2018 and we look forward to continuing to deliver strong profitable results in 2019.

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

Randall Lipps

2018 was a year of strong growth and evolution for Omnicell! It's clear that the Omnicell platform is winning and 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 for partnering with us, and the Omnicell team for executing on our winning strategy as we deliver our vision of the autonomous pharmacy and improve healthcare for everyone!

I especially want to thank Robin Seim for his over 13 years of exemplary service to the company. As previously disclosed, Robin will retire and join us on the Board of Directors next month. We wish him all the best and look forward to having him continue as a thoughtful advisor and leader in this new capacity.

Thank you everyone!