3Q19 Earnings Call

Good afternoon and welcome to the Omnicell third 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 October 24th, 2019, and all forward-looking statements made on this call are 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 provide an update on our business. After Randall's remarks, I will cover our results for the third quarter of 2019 and our guidance for the remainder of the year. Our third 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.

Good afternoon! We are pleased to share the results of another record quarter.

Key financial results from the quarter include:

1. Record revenue of $229 million up 12% from the third quarter of 2018
2. Record Non-GAAP EPS of $0.76 per share, compared to $0.63 per share in the same period last year, representing a 21% increase
3. Non-GAAP operating margins of approximately 17% up over 180 basis points from the third quarter of 2018

The value we are creating through our Autonomous Pharmacy vision is being realized every day, as more customers join us on our journey to revolutionize the pharmacy care delivery model. We are continuing to invest in technology to advance this vision. Our intention is for medications to be managed through a zero-error, fully automated and digitized infrastructure across the continuum of care.

The Autonomous Pharmacy vision 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 workflows, which includes expert services that serve as an extension of pharmacy operations. By connecting these solutions across the continuum of care, we have the opportunity to help solve for problems like prescription error, medical waste, medication adherence and opioid abuse; all significant industry-wide problems driving medical costs up and reducing the opportunity for better healthcare outcomes.

As we have previously discussed, our business has expanded over the years from a single point solution to a platform of products and services that we are developing further into the vision of the Autonomous Pharmacy. This has resulted in larger deal sizes across multiple products, and, we believe more comprehensive, valuable and enduring relationships with our customers. We're pleased to highlight our newest healthcare partnerships, including:

A 10 year renewal and expansion of the sole source agreement with Mercy. Mercy is one of the top five U.S. health systems, serving Arkansas, Kansas, Missouri and Oklahoma. This will support medication management and streamline workflows across their service network through Omnicell automation and intelligence solutions in Central Pharmacy and patient care areas.

We have also reached a renewed and expanded five year agreement with Vizient, the world's largest group purchasing organization, for our full portfolio of products, including XR2, IV workflow and robotics, and medication adherence solutions. Omnicell has been recognized with Vizient's Innovative Technology designation for our industry-leading solutions.

Salem Health Hospitals and Clinics, the premier healthcare provider for Oregon's Mid-Willamette Valley, has selected Omnicell solutions at its flagship Salem Hospital. Salem Health will be implementing Omnicell® XT Automated Dispensing Cabinets, along with integration to the hospital's electronic health record system, to streamline workflows, improve nursing-pharmacy efficiency and help enhance patient safety. Salem will leverage closed-loop interoperability functionality in the system to provide advanced medication tracking and diversion prevention.

In the Government sector, Durham VA Health Care System in North Carolina and Teague Veteran's Medical Center in central Texas have selected the Omnicell XR2 Automated Central Pharmacy system – an important technological step toward building a fully autonomous pharmacy. IV automation also continues to gain traction in this segment, as facilities including Cincinnati VA Medical Center and VA Los Angeles are adopting our IV workflow technology.

Now I'd like to turn the call back over to Peter to discuss the third quarter financial results as well as the guidance for the remainder of the year.

Thank you, Randall.

Our third quarter 2019 revenue of $229 million was up 12% over the third quarter of 2018 and up 5% from the prior quarter. The increase in revenue was largely due to an increase in XT Series implementations, growth in annual service and maintenance revenue from a larger installed base of equipment, as well as increased Population Health Solutions revenue. As discussed in the past, our Population Health Solutions include medication synchronization, patient messaging and other adherence solutions.

The third quarter Earnings per share in accordance with GAAP was $0.46, up from $0.33 per share in the third quarter of 2018. The increase in earnings per share is largely due to higher revenue in the third quarter of 2019 and achieving economies of scale over our operating expenses.

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, 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 effects of 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 acquisition and restructuring-related expenses. A full reconciliation of our GAAP to Non-GAAP results is included in our third quarter earnings press release and is posted on our website.

Third quarter 2019 Non-GAAP EPS was $0.76, compared to $0.63 in the same period last year representing a 21% increase. Similar to the increase in our GAAP EPS, the increase in earnings per share on a Non-GAAP basis is, again, largely due to economies of scale achieved in the context of higher revenue.

Non-GAAP other expenses for the third quarter of 2019 was $0.6 million compared to $2.2 million in Q3-18. The decrease primarily relates to lower interest expense as our outstanding debt balance has decreased and interest rates have fallen.

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

At September 30, 2019 our cash balance was $137 million, up from $87 million at June 30, 2019. Our outstanding funded debt was $80 million, resulting in a net cash position of $57 million. During the third quarter we did not sell any stock under our At the Market Program.

Cash flow from operations during the third quarter and nine months ended September 30, 2019 was $56 million and $110 million, respectively compared to $16 million and $57 million for the comparable periods last year. The increase in operating cash flows is primarily driven by increased net income and improvements in working capital.

Free cash flow generated in the third quarter and nine months ended September 30, 2019 was $42 million and $63 million, respectively, compared to $2 million and $15 million for the comparable periods last year. The increase in free cash flow is primarily due to the increases in operating cash flow mentioned earlier.

Accounts receivable days sales outstanding for the third quarter were 82 days, down 5 days from the previous quarter and down 11 days from September 30, 2018. The decrease in DSO from last quarter and the prior year is primarily due to higher sales and increased collections.

Inventories at September 30, 2019 were approximately $106 million, up $2 million from the previous quarter and up $7 million from September 30, 2018. The increase is primarily driven by demand for the XT Series product line.

Our headcount was 2,625 at September 30, 2019, up 70 from the end of the previous quarter and up 199 from the same quarter last year. The majority of the increase is for manufacturing, implementation, and service personnel needed to support our business as it continues to expand. We expect this hiring trend to continue as we grow the business.

Let's now move to guidance. The specific guidance for the fourth quarter of 2019 is as follows:

- We expect Total Revenue to be between $240 and $246 million.
- We expect Product Revenue to be between $181 and $186 million.
- We expect Service Revenue to be between $59 and $60 million.
- We expect Non-GAAP EPS to be between $0.75 and $0.80 per share.

Moving to our full year 2019 guidance:

- We expect 2019 Product Bookings to be between $765 and $790 million. This is unchanged from our previous guidance.
- We are narrowing our guidance range for 2019 Total Revenue. We now expect 2019 Total Revenue to be between $889 and $895 million. The midpoint of our updated and narrowed revenue guidance is approximately 13% year over year growth from our full year 2018 total revenue.
- This breaks down as follows:
    - We now expect 2019 Product Revenue to be between $653 and $658 million. Our previous guidance range was $653 and $663 million.
    - We now expect 2019 Service Revenue to be between $236 and $237 million. Our previous guidance range was $233 and $237 million.
- We are increasing and are narrowing our total year 2019 Non-GAAP EPS guidance. We now expect 2019 Non-GAAP EPS to be between $2.79 and $2.84 per share. Our previous 2019 Non-GAAP EPS guidance range was between $2.65 and $2.82 per share. The midpoint of our new Non-GAAP EPS guidance implies approximately 35% growth year over year.
- For 2019 we are assuming an average effective tax rate of 9% in our Non-GAAP EPS guidance range.
- Using the mid-points of the provided ranges we expect Non-GAAP Operating margin to be slightly above 15%

As Randall mentioned we are very pleased with the results for the third quarter of 2019 and we look forward to continuing to deliver profitable results in the fourth quarter.

Before we turn to the Q&A portion of today's call, I want to touch briefly on an informal inquiry we received from the SEC following the report from self-proclaimed short-seller GlassHouse that was issued in July. Such inquiries are not uncommon following reports like the one GlassHouse issued. We have responded and are fully cooperating with the SEC. We remain consistent in our July 15, 2019 response to the GlassHouse report.

With that, the purpose of today's call is to discuss our third quarter earnings and we ask that you keep questions focused on our results.

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

In just a few weeks, we will be sharing the progress we are making on our Autonomous Pharmacy roadmap with more than 25,000 pharmacy professionals and health care leaders attending the annual ASHP Midyear meeting. The value we are creating through this transformation of the pharmacy care delivery model is being realized every day, and I'd like to thank our customers for joining us on this journey as we continue to revolutionize the way medications are managed across the continuum of care.

Thank you to the Omnicell team for executing on this winning strategy and we look forward to closing out 2019 with strong partnerships and performance for the company.

Thank you everyone!

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

	Three months ended September 30,		Nine months ended September 30,	
	2019	**2018**	**2019**	**2018**
Revenues:				
Product revenues	$ 168,488	$ 149,709	$ 472,477	$ 415,004
Services and other revenues	60,317	54,558	176,258	160,555
Total revenues	228,805	204,267	648,735	575,559
Cost of revenues:				
Cost of product revenues	86,695	79,149	250,089	229,642
Cost of services and other revenues	29,963	26,209	85,337	75,770
Total cost of revenues	116,658	105,358	335,426	305,412
Gross profit	112,147	98,909	313,309	270,147
Operating expenses:				
Research and development	16,625	15,805	49,551	47,854
Selling, general, and administrative	70,876	65,609	207,588	196,831
Total operating expenses	87,501	81,414	257,139	244,685
Income from operations	24,646	17,495	56,170	25,462
Interest and other income (expense), net	(1,168)	(2,837)	(4,207)	(6,462)
Income before provision for income taxes	23,478	14,658	51,963	19,000
Provision for (benefit from) income taxes	3,495	1,030	12,720	(3,936)
Net income	$ 19,983	$ 13,628	$ 39,243	$ 22,936
Net income per share:				
Basic	$ 0.48	$ 0.35	$ 0.95	$ 0.59
Diluted	$ 0.46	$ 0.33	$ 0.92	$ 0.57
Weighted-average shares outstanding:				
Basic	41,771	39,432	41,283	39,015
Diluted	43,052	40,860	42,796	40,237

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

	September 30, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 137,277	$ 67,192
Accounts receivable and unbilled receivables, net	203,391	196,238
Inventories	105,813	100,868
Prepaid expenses	18,728	20,700
Other current assets	11,870	12,136
Total current assets	477,079	397,134
Property and equipment, net	54,877	51,500
Long-term investment in sales-type leases, net	21,494	17,082
Operating lease right-of-use assets	59,041	—
Goodwill	334,516	335,887
Intangible assets, net	129,163	143,686
Long-term deferred tax assets	30,607	15,197
Prepaid commissions	45,234	46,143
Other long-term assets	92,259	74,613
Total assets	$ 1,244,270	$ 1,081,242
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 48,449	$ 38,038
Accrued compensation	33,499	41,660
Accrued liabilities	58,017	43,047
Deferred revenues, net	88,205	81,835
Total current liabilities	228,170	204,580
Long-term deferred revenues	7,979	10,582
Long-term deferred tax liabilities	60,917	41,484
Long-term operating lease liabilities	52,738	—
Other long-term liabilities	9,798	9,562
Long-term debt, net	77,135	135,417
Total liabilities	436,737	401,625
Total stockholders' equity	807,533	679,617
Total liabilities and stockholders' equity	$ 1,244,270	$ 1,081,242

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

	Nine months ended September 30, 2019	Nine months ended September 30, 2018
Operating Activities		
Net income	$ 39,243	$ 22,936
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	39,525	37,490
Loss on disposal of property and equipment	436	136
Share-based compensation expense	25,175	20,851
Deferred income taxes	4,023	(8,849)
Amortization of operating lease right-of-use assets	7,917	—
Amortization of debt financing fees	1,718	1,718
Changes in operating assets and liabilities:		
Accounts receivable and unbilled receivables	(7,716)	(16,179)
Inventories	(7,015)	(5,288)
Prepaid expenses	(1,341)	774
Other current assets	974	3,120
Investment in sales-type leases	(5,120)	(1,732)
Prepaid commissions	909	991
Other long-term assets	3,944	(6,188)
Accounts payable	10,316	(8,439)
Accrued compensation	(8,161)	5,712
Accrued liabilities	5,262	1,482
Deferred revenues	3,900	9,014
Operating lease liabilities	(7,887)	—
Other long-term liabilities	4,086	(1,035)
Net cash provided by operating activities	110,188	56,514
Investing Activities		
Software development for external use	(34,129)	(22,213)
Purchases of property and equipment	(12,632)	(19,259)
Net cash used in investing activities	(46,761)	(41,472)
Financing Activities		
Repayment of debt and revolving credit facility	(60,000)	(27,000)
At the market offering, net of offering costs	37,806	—
Proceeds from issuances under stock-based compensation plans	35,029	27,729
Employees’ taxes paid related to restricted stock units	(5,790)	(3,648)
Net cash provided by (used in) financing activities	7,045	(2,919)
Effect of exchange rate changes on cash and cash equivalents	(387)	(373)
Net increase in cash and cash equivalents	70,085	11,750
Cash and cash equivalents at beginning of period	67,192	32,424
Cash and cash equivalents at end of period	$ 137,277	$ 44,174

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

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Reconciliation of GAAP revenues to non-GAAP revenues:				
GAAP revenues	$ 228,805	$ 204,267	$ 648,735	$ 575,559
Non-GAAP revenues	$ 228,805	$ 204,267	$ 648,735	$ 575,559
Reconciliation of GAAP gross profit to non-GAAP gross profit:				
GAAP gross profit	$ 112,147	$ 98,909	$ 313,309	$ 270,147
GAAP gross margin	*49.0%*	*48.4%*	*48.3%*	*46.9%*
Share-based compensation expense	1,316	1,150	4,194	3,346
Amortization of acquired intangibles	2,037	2,728	6,147	8,275
Non-GAAP gross profit	$ 115,500	$ 102,787	$ 323,650	$ 281,768
Non-GAAP gross margin	*50.5%*	*50.3%*	*49.9%*	*49.0%*
Reconciliation of GAAP operating expenses to non-GAAP operating expenses:				
GAAP operating expenses	$ 87,501	$ 81,414	$ 257,139	$ 244,685
GAAP operating expenses % to total revenues	*38.2%*	*39.9%*	*39.6%*	*42.5%*
Share-based compensation expense	(7,189)	(5,935)	(20,981)	(17,505)
Amortization of acquired intangibles	(2,545)	(3,029)	(7,891)	(9,393)
Severance and other expenses	(194)	67	(920)	(3,180)
Non-GAAP operating expenses	$ 77,573	$ 72,517	$ 227,347	$ 214,607
Non-GAAP operating expenses % to total non-GAAP revenues	*33.9%*	*35.5%*	*35.0%*	*37.3%*
Reconciliation of GAAP income from operations to non-GAAP income from operations:				
GAAP income from operations	$ 24,646	$ 17,495	$ 56,170	$ 25,462
GAAP operating income % to total revenues	*10.8%*	*8.6%*	*8.7%*	*4.4%*
Share-based compensation expense	8,505	7,085	25,175	20,851
Amortization of acquired intangibles	4,582	5,757	14,038	17,668
Severance and other expenses	194	(67)	920	3,180
Non-GAAP income from operations	$ 37,927	$ 30,270	$ 96,303	$ 67,161
Non-GAAP operating income % to total non-GAAP	*16.6%*	*14.8%*	*14.8%*	*11.7%*

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

	Three months ended September 30,		Nine months ended September 30,	
	2019	**2018**	**2019**	**2018**
Reconciliation of GAAP net income to non-GAAP net income:				
GAAP net income	$ 19,983	$ 13,628	$ 39,243	$ 22,936
Tax benefit for restructuring activity	—	—	—	(4,205)
Tax impact of IP restructuring	—	—	9,624	—
Share-based compensation expense	8,505	7,085	25,175	20,851
Amortization of acquired intangibles	4,582	5,757	14,038	17,668
Severance and other expenses[(a)]	767	506	2,639	4,899
Contingent gain	—	—	—	(2,456)
Tax effect of the adjustments above[(b)]	(1,123)	(1,315)	(3,501)	(4,222)
Non-GAAP net income	$ 32,714	$ 25,661	$ 87,218	$ 55,471
Reconciliation of GAAP net income per share - diluted to non-GAAP net income per share - diluted:				
Shares - diluted GAAP	43,052	40,860	42,796	40,237
Shares - diluted Non-GAAP	43,052	40,860	42,796	40,237
GAAP net income per share - diluted	$ 0.46	$ 0.33	$ 0.92	$ 0.57
Tax benefit for restructuring activity	—	—	—	(0.10)
Tax impact of IP restructuring	—	—	0.22	—
Share-based compensation expense	0.20	0.17	0.59	0.52
Amortization of acquired intangibles	0.11	0.15	0.33	0.43
Severance and other expenses	0.02	0.01	0.06	0.12
Contingent gain	—	—	—	(0.06)
Tax effect of the adjustments above[(b)]	(0.03)	(0.03)	(0.08)	(0.10)
Non-GAAP net income per share - diluted	$ 0.76	$ 0.63	$ 2.04	$ 1.38
Reconciliation of GAAP net income to non-GAAP Adjusted EBITDA[(c)]:				
GAAP net income	$ 19,983	$ 13,628	$ 39,243	$ 22,936
Share-based compensation expense	8,505	7,085	25,175	20,851
Interest (income) and expense, net	572	1,561	1,965	4,948
Depreciation and amortization expense	13,651	12,661	39,525	37,490
Severance and other expenses	767	506	2,639	4,899
Contingent gain	—	—	—	(2,456)
Income tax expense (benefit)	3,495	1,030	12,720	(3,936)
Non-GAAP adjusted EBITDA	$ 46,973	$ 36,471	$ 121,267	$ 84,732

(a) For the three months ended September 30, 2019, other expenses include $0.4 million and $0.2 million of amortization of debt issuance cost related to prior acquisitions and credit facilities amendments, respectively, and $0.2 million of tax restructuring costs. For the nine months ended September 30, 2019, other expenses include $1.2 million and $0.5 million of amortization of debt issuance cost related to prior acquisitions and credit facilities amendments, respectively, and $0.9 million of tax restructuring costs. For the three months ended September 30, 2018, other expenses include $0.4 million and $0.2 million of amortization of debt issuance cost related to prior acquisitions and credit facilities amendments, respectively. For the nine months ended September 30, 2018, other expenses include $1.2 million and $0.5 million of amortization of debt issuance cost related to prior acquisitions and credit facilities amendments, respectively, and $0.6 million of tax restructuring costs.

(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.