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COMPANY PARTICIPANTS

Doug Kuckelman - Benefitfocus, Inc., Head-Investor Relations
Matthew C. Levin - Benefitfocus, Inc., President, Chief Executive Officer & Director
Alpana Wegner - Benefitfocus, Inc., Chief Financial Officer

OTHER PARTICIPANTS

Jessica E. Tassan - Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Greetings and welcome to the Benefitfocus First Quarter of 2022 Earnings Call. At this time, all participants are in listen-only mode. A brief question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded.

I now have the pleasure of introducing your host, Mr. Doug Kuckelman, Head of Investor Relations.

Doug Kuckelman

Thank you, operator. Good afternoon and welcome to Benefitfocus' first quarter 2022 earnings call. Joining me today are Matt Levin, President and Chief Executive Officer; and Alpana Wegner, Chief Financial Officer. Matt and Alpana will offer some prepared remarks, then we'll open for questions.

Before we begin, let me remind you that today's discussion will include forward-looking statements that involve risks and uncertainties, and opportunities, and the impact of our growth strategy that could cause actual results to differ materially. For more information, please refer to Risk Factors discussed in our most recently filed Form 10-K.

We also will refer to certain non-GAAP financial measures. Important disclosures about those measures can be found in today's earnings press release. Lastly, we will reference a presentation furnished in an 8-K, which you can also find on our Investor Relations website at investor.benefitfocus.com.

With that, I'll turn the call over to Matt.

Matthew C. Levin

Thank you, Doug, and good afternoon, everyone. As I approach my one year anniversary with Benefitfocus, I have never been more confident that our company is on a path to achieve sustained growth. We are focused on making the necessary changes to create long-term value for our customers and shareholders. Today, I will cover our progress to date against our strategic plan and provide further insights on what to expect in the coming months. After that, Alpana will discuss our first quarter results.

Looking back at our work that started in the second half of 2021, I am proud of our team for taking decisive actions necessary to address a number of challenges to reposition the company for a return to growth, and importantly, to be a safe set of hands for our customers. The impact of our efforts to execute on our three-pillar strategy, which involves strengthening the core, growing with intent, and increasing operational efficiency can already be seen.

We identified and began improving many aspects of our customer service function with a specific focus on implementations and case resolutions. We also focused on platform enhancements for better data interoperability and expanding product offerings. These efforts have improved our go-to-market channel relationships and created meaningful leads and new prospects for future business. We believe all of these efforts will enable us to grow market share and solidify our position as an industry leader. We look forward to providing additional insight into our strategy, accomplishments, and longer-term financial targets at our Investor Day next week on May 10th.

Turning to slide 5, I would like to provide an operational update of the quarter where we hit a number of strategic milestones. I'd also like to give some insight into the selling season and discuss how we are delivering on our plan. Starting with our efforts to strengthen the core, we have concentrated on service excellence and we have been

delivering on our commitment. As I have said in the past, our associates' dedication to our customers is a unique competitive advantage and I'm grateful for all they do every day.

End-to-end service excellence is key to strengthening customer relationships, fueling a flywheel effect for sustainable growth. Having delivered the best open enrollment in our history at the end of 2021, we now expect to begin seeing the results from improved customer retention and increased customer references, which we anticipate will translate into a growing ARR base.

One of our investments to strengthen the core, the Tango Health acquisition, is off to a terrific start. Tango is already delivering greater levels of value to our customers with our expanded suite of administrative services, more advanced data management and delivery processes. We are now bundling Tango's suite of offerings in the new customer contracts and have started to cross-sell it with our current customer base. We believe this more robust and comprehensive solutions platform will help us improve attachment rates and grow our revenue.

I'm pleased to share that this quarter Tango achieved another year of 100% on-time filing of all ACA forms with the IRS and the applicable states. I want to thank and recognize our team. The execution on this was stellar, even in the midst of the acquisition and integration efforts. We are now beginning to migrate legacy Benefitfocus clients to the tango offering, which we expect will enable us to deliver even stronger customer performance going forward.

Service excellence is also critical to brokers and third-party evaluators, who are key players in our ecosystem, as they need to have confidence in service levels to refer business to us. As a result of our efforts to improve our go-to-market strategy through stronger channel relationships, we were recently included in Aon's Connected Benefit Solutions panel, a key listing from one of the top brokers in the world. This seal of approval along with referrals from other industry-leading brokers and third-party evaluators validates our work and should help to drive more business from both existing and new customers, particularly in our employer segment. I am grateful that our broker partners have helped us shift our company's narrative.

Moving to our efforts to grow with intent, through capital deployment, we're investing thoughtfully on the right opportunities at the right time. We're doing this through expanded product offerings, leveraging our data assets, and moving up market. During the first quarter, we conducted extensive technology and product research and discovery with our customers. This feedback drove decisions related to our product roadmap for both health plans and employers. Additionally, we have in place a number of innovative customer product pilots in the area of engagement. The initial feedback from customers has been very positive. We will have more to say about our product roadmap and pilot programs at our upcoming Investor Day.

Lastly, we continue to automate service and implementation processes to improve the customer experience and drive increased operating efficiencies. These cost savings are being reinvested in the organization to support our revenue growth strategy, while preserving our margins on a full year basis. We have a solid sales pipeline stemming from direct sales activities, improved broker channel relationships and SAP. We are optimistic that this plus our strong 2021 open enrollment will result in a successful sales season over the next several months. Our teams are now working through the most critical part of the sales season for employer, where final decisions are made by both current and prospective customers.

As a reminder, much of our employer market sales season generally runs through August and will have a meaningful impact on our revenues for 2023, whereas our health plan sales go throughout the year. Here too, we continue to see improvement in the overall market, but these are longer sales cycles. Given the nature of the business cycle in our industry and our subscription recurring revenue model, the majority of our sales made in 2022 will begin being reflected in our financials in Q4 and into next year. We look forward to reporting out on the results of the sales season on next quarter's earnings call.

Turning to slide 6. We are on track against our transformation plans and could not be more excited about the unique opportunity ahead of us. We believe we have a compelling value proposition as we grow our presence in a large and increasingly complex market. With more than 20 years of domain expertise and a unique technology platform, our investments in service excellence are fueling our growth strategy. Our seasoned team of industry leaders is focused on executing against our transformation plan. I am proud of the progress we've made in the last 11 months and I'm confident that we are on track to achieve our goals.

Before turning it over to Alpana to walk through the financial results, I'd like to welcome our new Chief People Officer, Kristin Adams, to our leadership team. I met Kristin when she worked at Morgan Stanley, and I am really excited to have her on the team. Kristin has ambitious plans to continue to make Benefitfocus an even better place to work and will support efforts to make sure we deliver an exceptional associate experience, which is a top priority for us, particularly in the current talent environment.

One of my early priorities was to put in place a first-class team. We believe the tenure and domain expertise of our team is unrivaled in our industry and it will drive our continued execution of our strategy to reposition Benefitfocus

and set the foundation for future success. I am also pleased that as I approach my one year anniversary at Benefitfocus, our leadership team is largely complete.

With that, I'd like to hand it over to Alpana, who will cover our financial performance.

Alpana Wegner

Thanks, Matt. I'll start with highlights of our first quarter financial results, and then I'll cover our guidance for the second quarter. Turning to slide 8 to take a closer look at our first quarter revenue, I'm pleased to report that we once again have our results at the high end of our guidance range. This marks the eighth consecutive quarter in which we have either met or beat our revenue guidance.

Total revenue for the quarter was $61.2 million. The 6% year-over-year decline was driven primarily by software services revenues, which were partially offset by the addition of Tango revenues this quarter. Total software services revenue was $49.7 million, down 7% year-over-year. Software services revenue include subscription revenue of $43.1 million and platform revenue of $6.6 million. Subscription revenue was down 5% year-over-year, driven primarily by the health plan attrition we experienced at the end of 2021 and discussed last quarter with you.

As a reminder, two health plans reduced the scope of their engagement with us and we continue to expect to see the year-over-year impact as we move through the first three quarters of 2022. Platform revenue was down 16% year-over-year, primarily driven by the accelerated timing of true-ups to platform revenue in the first quarter of 2021. These true-ups have historically taken place later in the year and the timing of which in 2021 resulted in a difficult year-over-year compare. Professional services revenue performed as expected, down 1% year-over-year.

Looking at our margin results on slide 9, GAAP gross margins were 51% versus 56% in the prior-year period. Non-GAAP gross margins were 53% versus 57% in the prior-year period. Software services GAAP gross margins were 64% in the first quarter versus 67% in the prior-year period, and software services non-GAAP gross margins were 65% versus 68% in the prior-year period. Our margins were impacted by planned ongoing investments in automation and process improvements which we're pleased to generate sustainable efficiencies beginning with the upcoming open enrollment later this year in the fourth quarter. As a reminder, given the seasonality of our business, our gross margins can fluctuate from one quarter to the next based on our sales and delivery cycles. We continue to expect to preserve our gross margins on a full year basis as we continue to reposition our business for growth.

Adjusted EBITDA was $11.2 million during the first quarter, approximately $2 million above the high end of our guidance range. We expect that this adjusted EBITDA overachievement in the first quarter was a result of timing of expenses that were pushed to the second quarter. Our adjusted EBITDA margin for the quarter was 18%, a decline from 23% last year, primarily driven by the investments in automation and process improvement I just discussed.

GAAP net loss available to common stockholders was $3.9 million and GAAP net loss per weighted average common share on a basic and diluted basis was $0.12. This compares to GAAP net loss available to common shareholders of $3.7 million, with GAAP net loss per weighted average common share on a basic and diluted basis of $0.11 in Q1 of last year. Non-GAAP net income available to common stockholders in the first quarter of 2022 and the same period in 2021 was $0.4 million, and non-GAAP net income per weighted average common share for basic and diluted was $0.01 for each of the periods. We exceeded the high end of our guidance range for non-GAAP EPS due to the overachievement in adjusted EBITDA discussed earlier, as well as a change in accounting treatment for our convertible notes and the associated noncash interest expense that was favorable to net income in the first quarter.

Moving on to our balance sheet and capital allocation on slide 10. We ended the first quarter with approximately $59 million in cash, cash equivalents and restricted cash, a decline of approximately $10 million from the fourth quarter, reflecting the timing of working capital changes. During the quarter, our free cash flow was negative $4.2 million, driven by the timing of customer collections and vendor payments. As a reminder, given the seasonality of our business, the free cash flow generation on a quarterly basis can fluctuate. We are confident we are on track to deliver our free cash flow guidance on a full year basis of $18 million to $24 million.

As we think about future uses of cash, we plan to continue to prioritize fortifying our customer service experience, accelerating our product roadmap, and pursuing select tuck-in acquisitions to accelerate our growth strategy. As of March 31st, our debt-to-adjusted EBITDA ratio was 4.4 times. I'll also note that our full $50 million line of credit remains available to us.

Shifting to slide 11 to discuss our outlook for the second quarter, we expect revenue between $55 million and $57 million, again, with the largest year ever decline in subscription revenue; adjusted EBITDA between $4 million and $6 million, reflecting the timing of expenses shifting from Q1 to Q2; and non-GAAP net loss available to common stockholders between $6 million and $4 million, which represent a non-GAAP net loss per share of between $0.17 and $0.11 based on 34 million basic shares outstanding.

As we look ahead, our expectations for the full year 2022, our revenue growth inflection point near the end of the year and our return to low-single-digit growth in 2023 remains unchanged. As a reminder, our 2023 outlook is predicated on three factors: one, momentum in our employer market having reestablished our industry credibility with both brokers and third-party evaluators; two, a recovery in demand from health plan customers for new solutions; and three, recognition of service improvements leading to improved levels of software revenue retention.

We plan to provide additional details on our longer-term financial targets during our Investor Day next week. I'm pleased with the progress we're making on executing our strategy to drive sustainable growth and I'm excited about the opportunity we have to unlock substantial shareholder value.

With that, Matt and I are happy to take your questions. I'll turn it back over to you, operator.

QUESTION AND ANSWER SECTION

Operator

Thank you. Ladies and gentlemen, we will now be conducting a question-and-answer session. The first question comes from Jessica Tassan of Piper Sandler. Please go ahead and ask your question.

Analyst: Jessica E. Tassan

Question – Jessica E. Tassan: Hi. Thanks for taking the question. So, for the two health plans that reduced the scope of their engagements with you guys, can you just help us frame how large their remaining contribution to revenue and EBITDA is and what you expect to happen for the remainder of those contracts? Thanks.

Answer – Matthew C. Levin: Yeah. Why don't I – hi, Jessica. Thanks for the question. Why don't I talk – I'll answer the second part of the question, and then I'll hand to Alpana on the first part of the question. So, of the two health plan clients that you talked about, they're still with us, obviously, and they re-scoped the work. Without getting into a ton of detail about it, our feedback from both of those clients is that the pieces that remain with us, which are variations of enrollment services, will stay with us for the foreseeable future. We haven't had any indication that either one of those would be re-scoped.

Answer – Alpana Wegner: Yeah. And just in terms of quantifying sort of the size of the ongoing contribution, what I'd say is that what we've provided is that the overall impact to 2022 is 3 points from a year-over-year growth from 2021 to 2022, and we're really not giving any additional guidance as we think about 2023 and forward. It's really in our guide for 2022 and we would – we wouldn't expect, as Matt said, those relationships were just recently sort of restructured and we wouldn't expect any fluctuations there in the near-term.

Question – Jessica E. Tassan: Got it. And then just – this is kind of higher level question, but did you see a pause in contracts being rebid or going out to RFP in 2020 and 2021, specifically in the employer market, just because people were distracted with COVID? And did that effectively paused attrition in those markets and mean that there is going to be a catch up sort of RFP process that's much larger this year during open enrollment – or sorry, during your selling season, so like right now?

Answer – Matthew C. Levin: Yeah. To be clear, we are in the middle of the sealing season. But just to be clear on that, we're in the – largely the employer part of our business which is in selling season, and even within the employer segment, it's the portion that where we go direct to clients or we sell through brokers, we obviously heard some comments around repairing or how a lot of those things have been repaired and how our brokers are increasingly important part of our distribution channel.

In terms of your question about 2020 and 2021, the answer is that during COVID, you saw a lot of activity, particularly employer just slow down. And if you put yourself in sort of the head of a benefits manager at the time or a head of HR, they were slammed with work around hybrid work supply, work-from-home, providing COVID benefits. If you remember, just the magnitude – the total magnitude of COVID in the labor markets, basically the entire expansion of the economy from the Great Recession leading up to COVID, all of the jobs created during that period of time, just roughly 20 million jobs plus, got evaporated in the span of six weeks in March and April of 2020. So, in that sort of economic context, bidding out, you've been out in the platform was just not a priority.

What we're seeing now is definitely a return to a more normalized level of sales activity, however, still in the jumbo market and you really have to segment the employer market between 10,000 jobs and 2,000 and below, and I'd say – and where we focus really 2 to 10 and then 10 up, the 2 to 10 market feels like it is coming back nicely. But the jumbo, the 10-plus is, in my view, still not back to pre-COVID levels of activity. But we are seeing a much more vibrant sales lease activity, broker connectivity, third-party valuator connectivity, and things are much more active than they've been in quite a while.

Question – Jessica E. Tassan: Got it. Thank you. And then, just last one is how are you defining the success of open enrollment? Like, what metrics should we be thinking about when you refer to it as such? Thanks.

Answer – Matthew C. Levin: Yeah. Sure. As we talked about, one of the biggest priorities from a customer service organization standpoint, one of the things I said in my first days here was that returning the company to a service excellence was one of my two top priorities. And in open enrollment, how we measure satisfaction is on a couple of different dimensions. On a quantitative basis, we send out surveys and the results of that are things like Net Promoter Scores, client SAT scores, et cetera. And then, on a more qualitative basis, I spend a lot of time personally with clients and they tell me about their experiences of their participants.

So, we get a lot of direct feedback from people who are using our platforms to enroll and they give us feedback that they feel like they made great decisions for themselves and their families. They talk about things like adoption of certain voluntary benefits and how that came to be very critical to them at moments and times of their life, for example, hospital visits, cancer diagnoses, et cetera. So, it's a mixture of quantitative and qualitative. When we say it was the best ever, we had specific metrics going in which we're happy about where we – how we hit them, and then we look at just how those metrics stack up year-over-year, and in all regards, this open enrollment season was terrific for us.

Question – Jessica E. Tassan: Got it. Thank you.

Answer – Matthew C. Levin: Thanks for your questions.

Operator

Thank you. The next question comes from Pinjalim Bora of JPMorgan.

Unidentified speaker

Question – Unidentified speaker: Hey, guys. This is Avi (00:25:11) on for Pinjalim. Congrats on the quarter and thanks for taking the question. I want to get your perspective on the current volatile macro environment that everyone is experiencing. Are you guys seeing any impact from there, whether in terms of direct business impact to just change in sentiment? And does any of the kind of macro environment kind of change of plans for medium-term plan mid-single-digit growth over the next couple of years? Thanks.

Answer – Matthew C. Levin: Yeah. Why don't I give you some qualitative observations first and then I'll have Alpana fill in with what – to fill in some of the blanks. I will tell you that, at a very high level, in terms of macro factors, the one that impacts us most is labor markets. So, just as during the recession, based on Jessica's question before, if you charge on per participant or a per employee basis when you have layoffs and bankruptcies, that's obviously a big problem. Obviously, we're not seeing that right now. What we're seeing right now is a very tight labor market, so – and that can be a tailwind for us.

So, what a lot of our clients are talking to us about, and like I said, we're in the middle of sales season, so that we spend time with clients throughout the year, but this is a particularly intense period of time. Our clients are trying to figure out, in addition to things like merit cycles and compensation and bonuses, they're spending a lot of time on benefits lineups, everything from mental health, hybrid work benefits, et cetera. So, they rely on us to give sort of a macro picture of what at a high level other companies and industries are doing to help attract and retain employees, because benefits are becoming an increasingly important component in terms of an employee value proposition, particularly with the adoption of things like CHPs and higher deductible plan.

So, I'd say that that is a net tailwind for us. I'll let Alpana comment on some of our quantitative factors, but like everyone else, I'll just be very direct with you. The great resignation and just talent wars, et cetera, has impacted everybody in the industry. I wouldn't say that we're an outlier in that regard and I'm pretty happy with how we're managing it. But I'd say labor issues are the big sort of macro factor for us, but with that, Alpana, (00:27:25)

Answer – Alpana Wegner: Yeah. No. I think you covered most of it there, Matt. From our cost structure standpoint, certainly, the labor costs are something we are keeping a close eye on in terms of the labor market that Matt referenced. And we do have several areas of targeted focus in terms of efficiency for the business that we feel like will certainly allow us to offset some of those increasing costs.

I think from a market perspective and from a demand, we're very mindful of what the impacts of inflationary environments can do for us. We do have some level of insulation, not only from the way our contracts are structured with minimums, but also in just the diversity of our customer base. We saw some of that during COVID. And to Matt's point, our business is on a PEPM basis, but we do have some insulation between the diversity of our customer base across various industry sectors. We predominantly serve enterprise as opposed to small business, and then the minimums that are put into our contracts give us some near-term protection.

I would say that we haven't seen necessarily the impacts from a demand standpoint from the metrics that we look at in the selling season. And I think that's somewhat attributed to the fact that benefits in healthcare are something that are pervasive trends that we see an ongoing need within the enterprise corporates in the health plans spaces that we serve. But we're super mindful of it, we can't control the macro environment, and we're continuing to monitor it to ensure that we get as much forward look into it as we can.

Unidentified speaker

Question – Unidentified speaker: Great. Thank you and appreciate that. And then, just to follow up on Tango. Any more color you guys can provide or just a little more detail, it sounds like it's going well. Are you guys sharing anything in terms of contribution from them? Thanks.

Answer – Alpana Wegner: Yeah. When we guided to 2022, we did share that Tango would contribute about 3 points of growth year-over-year. They are very subscription-based business, and so that you can think of that as being spread evenly throughout the year and that business is performing as we expected. So, we're very pleased with this initial quarter results, and as Matt shared, the service delivery was also very much in line with what we were expecting and our customers are seeing some really good outcomes as a result of that addition to our product portfolio and the team that's delivering on it.

Answer – Matthew C. Levin: Yeah. The only thing I would add to that is and just again, a huge shout out to the team in Austin, Scott and his leadership team there. I'm sure they're listening, which is why I gave them that quick shout out. The product is already being sold back to the base. We're bundling it in our new deals, and in all regards, I've done a lot of tuck-in acquisitions in my career and this is definitely in the top 10% of all that I've done, so huge kudos to that team.

Unidentified speaker

Question – Unidentified speaker: Thank you.

Operator

Thank you. Ladies and gentlemen, we have reached the end of the question-and-answer session. I would now like to hand the floor back over to Mr. Matt Levin for closing comments.

Thank you, and thanks, everybody, for attending today and thank you for your questions. Before closing out the call, I'd like to quickly summarize our plans and progress to create the shareholder value. Over the past year, we quickly addressed many of the underlying issues that impacted our past performance with a priority on improving and delivering consistent service excellence. We believe we have made meaningful progress (00:31:11) our efforts. We are getting more at-bats in the selling season, more referrals, and our reputation in the market is strengthening. We still have a lot of work to do, but we are confident that we have the right teammates to execute on our transformation strategy and are pleased with the progress to-date.

With that, thank you again for your time today. We look forward to our next quarterly update. And of course, we hope to see many of you next week, on Tuesday in New York for our Investor Day. With that, operator, I'll hand it back to you.

Operator

Thank you. Ladies and gentlemen, this concludes today's teleconference. You may now disconnect your lines. Thank you for your participation.