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CORPORATE PARTICIPANTS

Douglas Lee Braunstein *Talkspace, Inc. - Interim CEO & Chairman*

Jennifer Fulk *Talkspace, Inc. - CFO*

Mike Lovell;Senior Director, Investor Relations

CONFERENCE CALL PARTICIPANTS

Anna Kruszenski;Citigroup Inc.;Equity Research Associate

Charles Rhyee *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Nicholas Charles Spiekhout *William Blair & Company L.L.C., Research Division - Associate*

Yueli Zhang *SVB Leerink LLC, Research Division - Research Analyst*

PRESENTATION

Operator

Thank you for standing by, and welcome to the Talkspace Fourth Quarter and Full Year Earnings Conference Call. (Operator Instructions) As a reminder, today's conference call may be recorded.

I will now turn the conference over to your host, Mr. Mike Lovell, Director of Investor Relations. Please go ahead, sir.

Mike Lovell;Senior Director, Investor Relations

Good evening, everyone. Thanks for joining Talkspace's first annual earnings call. I hope you've had the opportunity to access the press release. We've also added a presentation to our earnings materials that you should see on Talkspace's IR site. We'll use the presentation to walk you through today's remarks.

We will begin with comments from Chairman and Interim Chief Executive Officer, Doug Braunstein; followed by Chief Financial Officer, Jennifer Fulk. Both are available for questions following our prepared remarks.

Certain measures we'll discuss on this call are expressed on a non-GAAP basis and have been adjusted to exclude the impact of one-off items. Reconciliations of these non-GAAP measures are included in our earnings release and on our website, talkspace.com.

I also want to remind you that we'll be discussing forward-looking information today, including forecasts, targets and other statements regarding our plans, goals, strategic priorities and anticipated financial results. While these statements represent our best current judgment about future results and performance as of today, our actual results are subject to many risks and uncertainties that could cause actual results to differ materially from what we expect. Important factors that may affect our future results are described in our most recent SEC reports and today's earnings press release. For more information, please review our safe harbor disclaimer on Slide 2.

And now, I'll turn the call over to Doug, who will begin on Slide 3.

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

Thanks, Mike, and welcome to Talkspace. Thank you all for joining us today to discuss both our fourth quarter and our full year 2021 results.

I'm going to begin with a snapshot of summary financial performance on Page 3, but I want to spend the majority of my time discussing the progress we've made in the past 3 months since we outlined our operational and execution priorities during our third quarter earnings call.

You can see on Slide 3, the '21 full year revenue grew 49% year-over-year, driven by significant growth in our B2B business, as demonstrated by the significant rise in B2B sessions, which more than doubled in 2021 as well as a continued shift towards higher subscription tiers in our B2C business, which drove an increase in ARPU. This was partially offset by a decline in B2C active users at the end of the period, which reflects our decision to reduce media spend in the fourth quarter in order to more effectively optimize B2C returns.

As we highlighted at the JPMorgan conference in January, the B2B channel has increasingly been the driver of growth in our business as we grow the number of eligible NBH and EAP lives, focus on initiatives to increase penetration in that membership base and continue to grow our enterprise accounts. Our B2B business covered approximately 69 million eligible lives as of December 31, up 75% from the prior year period, driven by new client wins, including Cigna and [Regis].

We expect to continue to add covered lives in the first quarter of 2022. We recently expanded our partnership with Optum in Q1 by adding a meaningful number of lives to our existing coverage. And we're planning to go live with a new large national insurer by the end of the quarter. Importantly, we've retained all of our significant customers as we began calendar year 2022.

We've also more than doubled the number of enterprise customers in '21, adding notable clients such as Blackstone, Expensify and West Virginia University. The recurring portion of our B2B business continues to increase and the strong momentum continues into 2022. We launched more enterprise accounts in January than in any other month in the company's history, while we also continue to shift our focus to larger enterprises throughout the course of the year.

If you turn to Slide 4, you'll note that the fourth quarter actual results have been updated since our estimates in January. While Jennifer will dive deeply into the details in the quarter, which involve some ongoing adjustments to our reserves in B2B, I do want to note 2 items. First, reported revenue for the quarter ended slightly above the high end of our guidance, reflecting modestly better-than-anticipated underlying performance in our B2B business, combined with a year-end favorable reserve allowance on receivables related to our prior period.

Second, as we noted in our preliminary release in January, B2C revenues declined in the quarter as we strive to optimize capital returns in our consumer business. A reduction in advertising spend modestly outpaced the decline in revenues, improving our quarterly contribution. And I would say, while we're in the early innings of our efforts here, we're starting to see signs of stabilization in a number of important metrics like conversion and retention.

So if you turn to Slide 5, you'll note that we identified these operational priorities in our third quarter call, and they're all listed here on this page. But before I go through some of the specific actions we've taken since November 15, I'd note that we believe we've made substantive progress across the organization in the past 3 months, adding targeted resources to the organization to accelerate growth, prioritize projects and, at the same time, we've begun to implement processes that establish that operational financial discipline we talked about.

While some of our early actions will improve our performance financially quickly, the bulk of our work will take time to impact our financial performance. But we believe that many of the operational issues we're addressing have clear solutions, and we believe we have both the resources and the team to address those issues swiftly. As a result, we remain optimistic that against the backdrop of our strong brand, our mission-driven and talented team, our unique product solutions and the ongoing macro environment that we serve that increasingly recognizes the need for accessible high-quality behavioral care. We can build a significant shareholder value over time.

Looking more closely at our priorities, I want to take each in turn. First, we believe there's a significant opportunity to take advantage of the synergies between B2C and B2B, unifying the customer acquisition funnel, leveraging the company's robust website traffic and brand awareness in the B2B space and simplifying the process to submit claims for all of our members.

We've implemented a number of changes in the funnel that we expect to drive improvements in our B2B2C conversion rate. And this means increasing the number of customers that visit our consumer website that ultimately use Talkspace as part of their insurance benefits. An upgraded version of the unify funnel is expected to be released by the end of this quarter. We've also recently launched Superbills, a feature that helps our members to expedite reimbursements for mental health service claims, particularly for out-of-network claims. We expect this initiative to further strengthen conversion and retention rates across our customer base over time.

Second, we've recently introduced a number of changes to increase our network's capacity and enhance Talkspace's value proposition for our clinicians. For example, we're actively assisting therapists today and adding licenses across several states to help alleviate regional provider shortages. In the state of Washington, for example, where there has been significant statewide shortages in experienced therapists, we've meaningfully increased our clinical capacity in the first quarter, directly as a result of the actions we took to improve licensing.

We've also redesigned our providers' compensation, improving the Talkspace value proposition for our therapists as well as increased training. Both of these actions are expected to improve engagement and assist in recruiting therapists to our platform. Again, we are beginning to see early signs of improvement in therapists retention and satisfaction as a result of these changes.

Third, we're investing incremental resources to fully capture the large and growing demand from our health plan and our enterprise partners. We've added meaningfully to our DTE sales organization in the first quarter, and we continue to expect to expand the team throughout the year. We've also allocated more marketing resources to the B2B side with the aim of driving both penetration and the utilization for our covered lives.

Fourth, we continue to focus on optimizing capital deployment for our consumer business. This includes reducing the media spend in the back half of the fourth quarter, while also more closely managing our refunds and our discounts. We've also, as I noted, observed a stabilization in our customer retention, driven in part by the recent efforts to unify the funnel and improve the onboarding experience and clinical tools for our providers.

Fifth, we've been focusing our efforts to develop several new products. This includes bundled offerings to better serve our enterprise customers' needs, including offering a range from self-help to therapy to psychiatry. We've also introduced live video sessions as part of our initial patient evaluation process, and we're finding that is improving the therapist-patient fit and early reactions to this change are quite promising. We've enriched our self-help content beyond couples therapy and improve the user interface for those patients. It offers more value and services that we can provide to our enterprise customers.

Sixth and finally, we continue to focus on optimizing cash flow over time. As I mentioned in our prior call, we believe we have ample cash resources to invest in the enhancements, the upgrades, expand our capabilities and ultimately deliver on operating leverage over time, but we've taken some specific actions. For example, we've already begun to implement a new billing and claims management system, which we expect will meaningfully reduce reserves and increase cash collections from our B2B business over time.

We've built out a full financial accounting and reporting team to improve both our reporting, our controls and, ultimately, we become a better allocator of the shareholders' capital. We've implemented a pricing committee to optimize our B2B customer mix and improve returns. And as I discussed before, we're optimizing our advertising spend across the B2C platform in order to improve contribution there as well. We believe that all of these initiatives allow us to leverage our platform and our cost base, enhance our cash flow over time and drive stronger competitive and financial performance.

With that, I'll turn the call over to Jennifer to provide more details on our operating and financial performance. Jennifer, over to you.

Jennifer Fulk - *Talkspace, Inc. - CFO*

Thank you, Doug, and good evening, everyone. Much of my discussion will be presented on a sequential basis comparing the fourth quarter 2021 results to the third quarter 2021. We believe this presentation is most useful to understand the business performance, given the shift in the revenue mix, the initiatives we started to implement in November and the rapidly changing competitive landscape.

Starting with Slide 6. Fourth quarter revenue was $29.2 million, up 11% sequentially on a reported basis from the third quarter. B2B revenue was $12.7 million, up 64% on a reported basis from the third quarter, attributable to approximately 18% growth in the underlying revenue from both an increase in B2B sessions and DTE customers. The remaining growth was due to changes in revenue reserves related to prior periods. When we normalize for these adjustments, B2B revenue would have been 10.1 and $11.9 million in Q3 and Q4 respectively. Our B2C revenue declined 12% in the quarter to $16.5 million, driven by a lower number of active users as we reduced our advertising spend by 15% sequentially, offset in part by an improved mix in consumer plans.

Our fourth quarter gross profit grew 13% sequentially to $16 million with a gross margin of 54.7%, up sequentially primarily due to lower revenue reserves on B2B receivables versus the third quarter. Absent these adjustments related to prior periods, fourth quarter margin would have been 53.5%, impacted by an increasing shift in revenue toward B2B and a greater number of full-time therapists.

Turning to Slide 7. GAAP operating expenses in the fourth quarter were $44.5 million compared to $39.4 million in the third quarter. Our GAAP cost base grew by $5 million quarter-to-quarter, mainly due to higher stock-based compensation and non-recurring items. Excluding these, fourth quarter operating expenses were down by approximately $1.5 million sequentially. This was driven by lower media spend, partially offset by higher employee-related expenses due to increased headcount, increased competition for talent and professional services fees.

Fourth quarter net loss was $21.1 million and adjusted EBITDA loss was $17.6 million. Our cash balance as of December 31 was $198 million. Excluding one-time items, our cash balance would have been approximately $200 million at the end of the quarter.

Turning to Slide 8 for a closer look at our B2B performance. As I mentioned earlier, B2B revenue for the quarter grew 18% on a normalized basis, which reflects an increase in the number of sessions as well as significant growth in our DTE customer base in the quarter. We ended the quarter with approximately 69 million eligible lives, an increase of 22% versus the prior quarter with a solid pipeline of additional lives going into 2022. As Doug noted, we see a significant opportunity to grow our B2B franchise, expanding our relationships with existing health plan partners as well as launching coverage with new payers.

The number of completed EAP and MVH sessions was up 14% sequentially in Q4, driven by modestly improved utilization of our services, while the number of active B2B users at the end of the period declined 1.5% to 31,800 as of December 31. This is due to a decline in therapist activity during the holiday season. We have already seen a rebound in January in active B2B users. We added 19 enterprise customers in the fourth quarter and grew DTE revenue more than 19% quarter-over-quarter. This recurring revenue is more than 40% of our B2B business. And as Doug mentioned, we have launched several new accounts already this quarter.

Turning to Slide 9 for a closer look at our B2C performance. Revenue declined 12% sequentially, driven by a 15% decline in active users, partially offset by an increase in ARPU as our members continue to migrate towards higher subscription tiers. We spent less money on media, in line with the expectations we outlined last quarter. Advertising spending was down 15% sequentially as we work to optimize capital returns in our consumer business. The reduction in advertising spend outpaced the revenue decline, modestly improving our quarterly contribution.

Turning to our conclusion on Slide 10. As we discussed during our third quarter earnings call and reiterated last month at the JPMorgan conference, we are taking tangible steps to improve performance. This includes unifying the B2B and B2C funnels to improve conversion, strengthening our clinical network to drive utilization and retention, optimizing our B2C returns and expanding our product suite. While the initiatives outlined today will take some time to materialize in our reported results, we believe those will drive growth and profitability over time. And we look forward to keeping you updated on our future progress.

With that, we'll open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Ryan Daniels of William Blair.

Nicholas Charles Spiekhout - *William Blair & Company L.L.C., Research Division - Associate*

This is Nick in for Ryan. I guess, just to start, if you can provide a little bit of an update on the W2 workforce transition. I know I think we asked in the past that there was kind of a time line you guys were going on, if you have any changes there, I appreciate that.

Jennifer Fulk - *Talkspace, Inc. - CFO*

So we had not mentioned this specific time line, but I can tell you just the evolution that we made and the progress we've made over the last few months. So we did hire -- we had higher W2s overall for the fourth quarter, but we did make progress on some operational efforts related to that. So as Doug mentioned earlier, enhancements around productivity and capacity of the network. At this point, we don't have a specific plan for the network overall or we do have those operational efforts in place to improve the capacity and utilization of that.

Nicholas Charles Spiekhout - *William Blair & Company L.L.C., Research Division - Associate*

And then, I guess, next, you've mentioned in the past that you need to do a better job kind of bundling product offerings. I'm wondering how you're tracking there. And is there any other metric other than just kind of like RPU that you guys are tracking like multi bookings or something like that, that you guys are tracking that you can update us with?

Jennifer Fulk - *Talkspace, Inc. - CFO*

Yes. So we did have a few advancements and we have initiatives with regard to bundling our product offering. And I would say that has gotten traction with our payers. We mentioned the progress that we made both with regard to enterprise clients as well as expanding lives within our payer accounts. I would attribute a lot of that success to us bundling our services across our self-help platform as well as our therapy and our psychiatry services. Outside of that, I don't have anything other specific to recognize as far as the portfolio combination.

Operator

Our next question comes from Charles Rhyee of Cowen.

Charles Rhyee - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Doug, maybe I wanted to talk about -- you talked about optimizing media spend. And obviously, we can see there is a direct correlation between media spending and membership of growth. Can you give an example -- when you're saying optimizing, can you give us some examples of what you are doing in this regard? Like, how can we sort of -- what does that actually entail?

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

Jennifer, do you want to?

Jennifer Fulk - *Talkspace, Inc. - CFO*

Yes, I'll start, Charles. Thanks for the question. So in our third quarter call and then at JPMorgan, we talked about our rising cost of acquisition and that primarily being driven by a declining conversion. Our stabilization of conversion was really positive to see in the fourth quarter. On top of that, we've made specific efforts as we look to optimize the spending in the channel. So specifically as you asked related to analytics and working with a third-party to better understand the ROIs of our spending channels as well as investment in a marketing agency to better make sure that we're kind of spending and optimizing getting the most efficient spend from those dollars.

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

And I would just add, as both Jennifer and I talked about, the unification of the funnel. So taking the same traffic that is coming to our website, but easing the access and experience for our covered lives, our insured lives, directly impacts CAC LTV and all of the key metrics. So it is literally turning a live that otherwise a potential visit to the website that would otherwise decide not to pay out of pocket that gives them an alternative. And I would add, for those that are paying out of pocket, the Superbill function that we've just recently launched is another -- it's early, early days of that new product. It's another way to extend the duration of that customer and increase retention. So a lot of what we're talking about, both in terms of the specific optimizations that Jennifer talked about as well as the unification of the funnel really go to improving the economics of our media spend.

Charles Rhyee - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

And maybe if I could just follow-up. One of your largest competitor here in this space talked about that the media spend or sort of those kind of costs, they're seeing it kind of down a little bit from a year ago. Can you give us a sense of what you're seeing in terms of cost for media spending right now? And sort of what do you kind of expect here for at least maybe for the first part of the year?

Jennifer Fulk - *Talkspace, Inc. - CFO*

So just on the first element there, Charles. I would say that higher cost of advertising has not been a significant factor for us. It's continuing on into the fourth quarter. And to-date, the bigger factor are the things that we've talked about as far as conversion goes. As far as our level of media spending, as we mentioned, we reduced that in the fourth quarter. We'll continue about that same level of spend as we look to prioritize investments outside of media into our talent and our processes and infrastructure building out the process -- building out the product so that we can scale.

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

I mean, just to be clear, Charles, the economic driver for us is conversion. The marginal cost of advertising at this point isn't the material mover value. It's driving conversion and retention. Those 2 elements are where -- and obviously, as Jennifer said, we're going to optimize the dollars that we spend and take advantage of better analytics and methodology in doing so. But the real driver of value for us is going to be around conversion and retention.

Charles Rhyee - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Sorry, one last follow-up for me, and then I'll jump back in. I think Talkspace had a lot of, what you call, a lot of awareness driven by some strong spokespeople that you had gained. I wanted to see if you still have some high profile spokespeople engaging for the company and sort of there's any kind of change in the strategy for that going forward?

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

Yes. I'll answer by saying, we continue to have really outstanding brand recognition. And we continue to invest behind that because, again Charles, brand not only works in driving our B2C business, but it is increasingly an important component of building out our B2B business and the utilization of those millions of lives we have, that's very important. We're not going to comment on the specific spokespeople other than to say, you may have seen -- we just launched a series of new advertising, and you can certainly go on YouTube and look at the Michael Phelps ad. It's an excellent one.

Operator

Our next question comes from Daniel Grosslight with Citi.

Anna Kruszenski;Citigroup Inc.;Equity Research Associate

This is Anna Kruszenski on for Daniel. First, I had a question on how membership duration is trending and how that varies between the B2C and B2B channels. I think in the past, you guys have said that the average duration is about 5 months on the platform. And just curious if that still holds and how that compares to B2B numbers.

Jennifer Fulk - *Talkspace, Inc. - CFO*

We see in our current data in our B2C business, we have roughly 4 months of average duration of those members in the B2B business.

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

Can I just interrupt one second? We haven't seen a decline in that, Anna. We're just saying it has been consistent at around that level for a period of time now.

Jennifer Fulk - *Talkspace, Inc. - CFO*

That's right. And as we look to the B2B business, the equivalent of duration, we would call utilization. And I would say, our current rates were much less than what we see in the B2C business. And that is why it is such a significant opportunity for us. So as we work on efforts across the platform, both on conversion, which is penetration in our B2B business as well as retention, which is equivalent to utilization and duration in the B2B business. Those efforts will pay off as we look to increase that duration overall of our members.

Anna Kruszenski;Citigroup Inc.;Equity Research Associate

And then, as a follow-up on that, you guys are noting like a higher mix of video visits in the B2C channel last quarter, which has led to a few uplift. I was wondering if the average duration of the video visits was also about 4 months like that?

Jennifer Fulk - *Talkspace, Inc. - CFO*

We don't measure duration as far as what modalities our members choose. So our comments on higher mix, so higher selection of the more premium subscription areas, it includes asynchronous communication as well as the video sessions.

Operator

Our next question comes from Stephanie Davis with SVB.

Yueli Zhang - *SVB Leerink LLC, Research Division - Research Analyst*

This is Joy Zhang on for Stephanie. Given that you had a departure in your C-suite of someone who's heading the shift towards B2B, how should we think about the growth outlook for the B2B business compared with the projections you provided when you came public?

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

I'm not going to comment on the projections provided by the prior management. I will say that, as you know, the first 2 quarters with the prior management were misses in estimates. What I will comment on is that, as I mentioned on our call in January, December was our strongest month for DTE sign-ups. It has actually been exceeded in the month of January. We added covered lives in December, in January, and we continue to do so in February. We have added resources in the first quarter to our B2B business. We've added marketing spend in our B2B business. And we've also added a whole series of control functions, pricing discipline and billing discipline to ultimately optimize not only our revenue but the cash generation from those businesses.

So I would say, today, our B2B business is stronger than it was on November 15, and we expect it to continue to gain momentum through the course of 2022. We have not, and we are not, for the moment, providing any guidance around where those businesses will be, in part because as we said -- I said at my opening comments and Jennifer said, while we're making lots of changes, many of those things will take time to come to fruition, but we're, we believe, confident that the changes we're making will ultimately strengthen the business. So that's how we feel about it today. We feel better today than we did on November 15.

Yueli Zhang - *SVB Leerink LLC, Research Division - Research Analyst*

Maybe as a follow-up. We've seen some high-profile transactions in the [health Talkspace] in the past few months. So maybe can you just walk us through the value of being a stand-alone company versus being acquired by maybe a large payer or a provider?

Douglas Lee Braunstein - *Talkspace, Inc. - Interim CEO & Chairman*

I would say, we're focused as a management team on optimizing the value of the company to our shareholders. As the Chairman of the Board, I would say that we always have the interest of optimizing value in whatever fashion creates the most value for our shareholders. But right now, the things under our control are to run the business better, to grow our B2B franchise, to optimize our B2C business, to improve our network, to increase and improve our controls and financial rigor and discipline and cash flow generation. And so those are the things we're focused on, and we think that's going to deliver a lot of value over time. And we will remain open to any pads that get us to value.

I think that's our -- unless I'm mistaken, I think that's our last question. So thank you for everyone for the excellent questions and for participating in the fourth quarter and year-end call. And Jennifer and Mike and I look forward to speaking one-on-one with our shareholders and our upcoming performance in 2022. So thanks very much, everyone.

Operator

Thank you. Ladies and gentlemen, this does conclude today's conference. Thank you all for participating. You may now disconnect. Have a great day.