
Castlight
Castlight Health
Q4 2019 Financial & Business Update
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(NYSE:CSLT)
Q4 FY 2019 | 1

Safe Harbor Statement

Good afternoon and welcome to the Castlight Health fourth quarter and full year 2019 conference call. Leading today's call are Maeve O'Meara, chief executive officer, and Will Bondurant, chief financial officer. Maeve and Will will offer their prepared remarks and then we will take your questions. Our press release, webcast link and other related materials are available on the investor relations section of our website.

This call contains forward-looking statements regarding our trends, strategies and the anticipated performance of our business, including – but not limited to – our guidance for full year 2020, new sales, retention of existing customers, gross margin and operating expense trends, cash use, future cash position, and the impact of management changes and changes in our growth strategy on the Company's performance. These statements are made as of February 25, 2020, and reflect management's views and expectations at this time, and are subject to various risks, uncertainties and assumptions. If this call is replayed after February 25, 2020, the information in the call may no longer be current or accurate. We disclaim any obligation to update or revise any forward-looking statements.

This call contains financial guidance, but we will not provide any further guidance or updates on our performance during the quarter unless we do so in a public forum. Please refer to today's press release and the risk factors included in the company's filings with the Securities and Exchange Commission for discussion of important factors that may cause actual events or results to differ materially from those contained in our forward-looking statements.

Today's presentation also includes certain non-GAAP metrics, such as non-GAAP gross margin, operating expenses, operating loss, and net loss per diluted share that we believe aid in the understanding of our financial results. A reconciliation to comparable GAAP metrics, on a historical basis, can be found in the appendix section of our earnings release filed before the call.

With that, I'll turn the call over to Maeve O'Meara, CEO of Castlight Maeve?

CEO Section:

Thank you for joining us on today's call. Q4 was another strong quarter of delivery against the top priorities I laid out in July after stepping into the CEO role: solidify our Anthem relationship; execute on concrete initiatives to reinvigorate our direct-to-employer business; establish new growth vectors; and build out our executive team to lead the Company into our next chapter. The team's achievements over the last two quarters have put the Company in a significantly stronger position than it was just six months ago. More importantly, I believe our work over the second half of 2019 sets the foundation for continued execution in 2020 that, ultimately, will allow us to put the Company back on the path to sustainable growth.

In July, we shared our thesis on the need to leverage our technology more fully in the ecosystem. In the immediate term, the broader applicability of our technology is demonstrated in our clear two-part growth strategy. First, we are re-invigorating our direct-to-employer business, building on our position of strength as the market leader. Second, we are expanding our addressable market by building new and durable revenue streams across the broader ecosystem, starting with serving health plans. We believe this expanded strategy for platform monetization will benefit all of our stakeholders, and our work over the last two quarters positions us well for 2020.

I'll begin the call by reviewing our primary achievements in the fourth quarter and then share our 2020 priorities. Afterwards, I'll turn the call over to Will, who will review our Q4 financial results and outlook for this year.

We ended 2019 with annualized recurring revenue, or ARR, of $147 million, which exceeded the $140 million to $145 million target range we shared with you in October. ARR reflects the expansion of the Anthem agreement we signed in October, improved renewal activity in Q4 relative to plan. We are encouraged by the ARR results, and we're also excited to share a number of other areas of tangible progress in Q4.

First, we reached an important milestone by completing all customer migrations off of the legacy wellbeing technology and onto our single-stack Castlight platform. This is a key financial and operational milestone, as it: (1) reduces our costs as we will no longer need to support two tech stacks; (2) enables us to re-accelerate our pace of innovation; and (3) allows our employees to turn the page and move forward as a strong, unified team.

Second, we successfully launched the first pilot of our high-touch offering, Castlight Care Guides, in November with a Fortune 500 manufacturing company and Castlight Complete customer. As a reminder, Castlight Care Guides is our high-touch offering that leverages our platform to provide personalized support to members who have complex needs or simply require more assistance in navigating barriers to care. To date, we've seen strong early results with demonstrable user impact, including multiple examples of our ability to support users in resolving billing errors.

Care Guides leverages our deep data infrastructure and AI-enabled personalization to predict a user's next best action and thus deliver high-touch navigation that's targeted and cost-effective alongside Castlight's engaging digital app experience. Because this offering is an extension of our existing platform, we are uniquely positioned to offer high-touch services while maintaining our long-term gross margin profile.

Employer demand for navigation continues to rise with the National Business Group on Health's latest report showing that employer use of these services is expected to grow from 39% in 2019 to 60% in 2020. We are on-track to make this new service generally available in Q3 and have enabled our field teams for this sales season.

Third, we met our goal of hiring an experienced commercial leader by the end of the year. This was a critically important hire that we needed in place to lead our 2020 growth efforts, given the seasonality of our business. I'm excited to say we hired our leading candidate and in December we welcomed Keith Reynolds as our new chief commercial officer. He's leading both our sales and customer success functions, which unifies the management of our two key ARR drivers -- new business and customer retention -- under one executive.

Keith brings 25 years of healthcare sales and customer success experience from leadership roles at CVS Health and Aetna, serving most recently as vice president of health plans and market strategy at CVS. In addition to broad sales and account management responsibilities, he led the commercialization of many digitally focused plan solutions while at CVS, and also drove growth at a smaller company during Caremark's early days. Keith is known in the industry as both an experienced and accomplished sales leader. Keith chose Castlight because of a belief in the market and his assessment that Castlight possesses both the strongest technology and team to attack this opportunity.

Keith opened the 2020 selling season with our sales kick-off event in January where the team was trained and certified on new messaging, demos, and sales plays. Keith is partnering closely with our newly promoted SVP of Marketing, Tamar Rudnick, a six-year Castlight veteran who served most recently as our VP of Product Strategy and Analytics. Tamar is well positioned to leverage her deep knowledge of our buyer, our market, and our product to support Keith in returning the company to growth. Tamar was instrumental in both defining and bringing Complete to market; her experience leading analytics will be particularly valuable as we seek to leverage more proof points in our go-to-market motion.

In addition to the Castlight Care Guides pilot and the significant enhancement of our commercial leadership, we continued our work on the necessary infrastructure to drive more value, improve operational excellence, and develop deeper relationships with our customers and users. During the quarter we continued the build out of our customer center of excellence in Salt Lake City and are on-track to open our permanent office space. This is a great example of the team’s ability to execute on a new initiative in a short time frame to reinvigorate our employer business.

Fourth, we made further progress on our strategy to unlock new growth vectors, starting with health plans. There is a clear opportunity to leverage our technology to support health plans in improving health navigation for their members, and Anthem provides a powerful proof point of our ability to effectively partner with health plans. In our last call, I discussed our work to establish the team, the go-to-market plan and the pipeline. In Q4, we built on this foundation and have progressed from meetings to active proposals with multiple health plan prospects.

The three areas where we are having the deepest discussions are the full navigation platform, transparency and personalization. Transparency has been particularly top-of-mind, including provider directory, provider quality scoring, and value-based networks. Our white-labeled navigation platform coupled with the ability to embed our functionality into a plan's user experience allows us to meet the health plan where they are on their technology journey.

As we kick off the new year, I am energized by how far we've come in two quarters. For 2020, our priorities are to build on these early successes. We are focused on four goals:

First, we will continue our work to revitalize our direct-to-employer business. The leadership of Keith and our extended team are critical to executing on the fundamentals to enable improved sales and retention. We have spoken about the need for operational excellence, credible value, continuous innovation, and strong relationships to support a healthy book of business. We are taking concrete actions against all of these levers, including a significant shift in executive engagement in both sales and retention. With Tamar stepping up to lead marketing and new leadership in our analytics team, we are well positioned to support Keith and his teams with refreshed messaging, collateral, and most importantly, clear demonstration of value.

We are also entering the year in a stronger position with over half of our non-Anthem book of business now on Complete.

Our second goal is to build on the early success of our Castlight Care Guides pilot and make the offering fully available in Q3 as we deliver the product and introduce it to prospects and customers. What we see and hear in the market supports the National Business Group on Health case study – we have seen significant interest in digital and high touch services, with some prospects viewing high-touch as an attractive add-on capability post launch. We believe we are uniquely positioned to address the hole in the market for a cost effective, digital plus high touch solution.

Our third goal is to sign at least one new health plan customer deal in 2020. While sales cycles here are typically 12 to 18 months, we are moving concrete opportunities through the pipeline. We are in a much stronger position with our health plan go-to-market than we were this time last year, due to a dedicated team, developing pipeline, and proof point of our expanded Anthem relationship. We expect to continue partnering closely with Anthem to ensure we deliver value and innovate with our Engage customers, while also adding new membership to the platform.

Our fourth goal is to maintain gross margin and improve our operating loss profile as compared to 2019. We are making investments in Castlight Care Guides, given the value of high tech plus high touch navigation in the employer market. That said, we expect to see cost savings from the completion of our Salt Lake City office and R&D efficiencies. We believe we can invest in growth while reducing our loss in 2020.

We are excited to turn the page on 2019 and begin 2020 with optimism and urgency. Looking back, I'm proud of what we've accomplished since July: we delivered on our promise to expand and extend our Anthem relationship, jump-start a new health plan sales initiative, deliver real product innovation, and enhance our executive leadership. Looking forward, we will use this progress as the foundation for 2020. We have more work to do to fully change the trajectory of our business, but I believe we have the right team in place, the strongest product in the market, and a visible path to return the company to sustainable growth.

I want to thank the entire Castlight team for rising to the challenge in 2019 and jumping into 2020 with pride and purpose. I'll now turn the call over to Will, who will review our Q4 financial results and 2020 outlook. Will?

CFO Section:

Thanks, Maeve. Good afternoon and thank you for joining us today. Our fourth quarter's financial results reflect continued progress and investments associated with our second-half priorities. We drove sequential ARR growth and improved the stability of our customer book while making targeted and careful investments in the right leadership, technology and infrastructure to accomplish the strategy Maeve just outlined: reinvigorate our direct-to-employer business and begin penetrating the health plan market.

Annualized recurring revenue, or ARR, totaled $147 million at year-end, up $10 million sequentially from Q3. This increase was principally driven by the incremental ARR from the October Anthem enterprise license agreement and improved execution on renewals in Q4 relative to plan. As a reminder, Q4 is a seasonally light sales quarter and a heavy renewals quarter. While churn is a lagging indicator, we believe the improvement on renewals against our expectations was driven in-part by the strategy discussed in Q3: delivering credible value, continued innovation, and deeper partnerships with our employer customers. As we made progress against these principles, we did sign a small number of customers to short-term extensions in Q4 that enable us to continue our renewal dialog with them into Q1. These renewal discussions are ongoing and their outcomes will be reflected in ARR at the end of Q1.

We ended the year with net dollar retention, or NDR, of 94%, which includes the substantial impact of our Anthem renewal and expansion in October. Net of the Anthem impact, NDR would have been in the low 80% range and consistent with the level we saw at year-end 2018.

Looking ahead to 2020 renewals, we are encouraged that 75% of ARR is associated with direct Castlight Complete or Anthem. As we said in July, we do believe our point solutions are still at-risk of elevated churn. However, they now account for only one-quarter of our book and we expect them to benefit from the investments we have discussed around retention.

Revenue was $36.4 million in the fourth quarter and $143 million for full-year 2019, in-line with our annual revenue guidance range of $140 to $145 million. Subscription revenue accounted for 95% of total revenue and was in-line with our plan. Q4 revenue included approximately $0.9 million of non-recurring revenue related to the end of customer contracts and performance guarantees. As you may recall, we had a similar dynamic in the fourth quarter of 2018 with $1.5 million of non-recurring revenue and in Q4 2017 with $0.5 million of non-recurring revenue.

Professional Services and Other revenue exceeded our expectation due to higher levels of wellbeing users redeeming incentive points for gift cards in the fourth quarter using the Reward Center feature. While this activity is not our core product offering or business focus, user redemptions generate revenue for Castlight that's net of the gift card cost and fulfillment. In Q4, we saw higher than expected revenue associated with these redemptions, which we believe was due in part to improved stability from re-platforming and Wellbeing customer migrations and by seasonality of the business with end-of-year spend deadlines.

Now, let's turn to our fourth quarter non-GAAP financials.

Fourth quarter non-GAAP gross margin declined to 58%, driven by a $1.9 million increase in cost of revenue. This increase was primarily driven by one-time factors: first, the write-off of amortized professional services fees for terminated customers and, second, the investment in our Utah Customer Center of Excellence. In 2020, we expect to return to the gross margin levels we discussed on our prior call: mid-70% subscription gross margin and low-60% total gross margin.

Non-GAAP operating expenses totaled $29.2 million, which include a non-recurring write-off of amortized commission expense in sales and marketing associated with 2019 terminations and an uptick in G&A due primarily to executive recruiting expenses as we have built-out our team.

Based on these factors, fourth quarter non-GAAP operating loss was $8.1 million. We generated $4 million in cash from operations in Q4 and ended the year with approximately $60 million in cash and marketable securities, essentially in-line with our expectations.

With that, I'll now provide our outlook. As Maeve mentioned, 2020 will be a year of continued transformation for Castlight and we are focused on ensuring our resources are deployed efficiently to achieve our strategy and return Castlight to sustainable growth. In terms of our 2020 financials, we currently expect:

- Revenue in the range of $130 million to $135 million
- Non-GAAP operating loss between $17 million and $22 million

- And non-GAAP loss per share between $0.12 and $0.15 based on 150 to 151 million shares.

The revenue guidance reflects: first, the impact of the new Anthem enterprise license agreement, which became effective with ratable revenue recognition on January 1st; second, 2019 terminations becoming effective in 2020; and, third, fewer 2019 direct-to-employer sales with 2020 launch dates. Given our new Anthem relationship does not tie revenue recognition to client launches and our 2019 sales were light, we do not expect to see the revenue growth sequentially in each quarter over the course of the year that we have seen historically.

Given the investment in our Utah Customer Center of Excellence and the initial deployment of Castlight Care Guides, we expect total non-GAAP gross margin to be in the low 60% range with subscription gross margin remaining in the mid-70% range for the full year 2020. In terms of non-GAAP operating expenses, we currently expect sales and marketing to be within its long-term target range of 20 to 24% of revenue. While R&D will remain above our 20 to 24% target range, we expect to see a high single-digit percent reduction in R&D expense on a dollar basis year-over-year, partly driven by the elimination of the Jiff platform. We expect G&A to be up on a dollar basis versus 2019, reflecting continued costs of security, compliance, investments in operations and talent acquisition.

We expect cash used from operations to be in the range of $12 to $17 million and expect to end 2020 with more than $40 million in cash. As with 2019, we expect to see net operating cash flow use highest in the first quarter.

As Maeve mentioned, we are focused on aligning resources against key strategic priorities that will return Castlight to growth. We are proud of the efforts of the past six months and our team is hard at work to execute further in 2020 on behalf of our customers and shareholders. Operator, we will now take questions.