Omnicell Second Quarter 2023 Financial Results
August 1, 2023 – 1:30pm PT/4:30pm ET

Kathleen Nemeth:

Good afternoon and welcome to the Omnicell second quarter 2023 financial results conference call. On the call with me today are Randall Lipps, Omnicell Chairman, President, CEO, and Founder, and Nchacha Etta, Executive Vice President and Chief Financial Officer.

This call will contain forward-looking statements, including statements related to financial projections or other statements regarding Omnicell's plans, strategy, objectives, goals, expectations, cost savings actions, or outlook that are 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 issued today, in the Omnicell annual report on Form 10-K filed with the SEC on March 1, 2023, 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. All forward-looking statements speak only as of the date hereof or the date specified on the call. Except as required by law, we do not assume any obligation to update or otherwise release publicly any revisions to our forward-looking statements.

Our results were released this afternoon and are posted in the "Investor Relations" section of our website at ir.omnicell.com. Additionally, we would like to remind you that during this call we will discuss some non-GAAP financial measures. Reconciliations of these non-GAAP financial measures to the most comparable GAAP financial measures are included in our financial results press release issued today. With respect to forward-looking non-GAAP measures we do not provide a reconciliation of forward-looking non-GAAP measures to the comparable GAAP measures on a forward-looking basis as these items are inherently uncertain and difficult to estimate and cannot be predicted without unreasonable effort.

With that I will turn the call over to Randall. Randall?

Randall Lipps:

Good afternoon and thank you all for joining us today.

Today, I'll walk through our performance this quarter, including our key customer wins and trends we're seeing in our business and the industry. I'll also provide an update on our outlook for the remainder of 2023.

Let me begin with our results, which reflect sequential revenue growth and, we believe, continued financial discipline from the Omnicell team. Through strong execution, we exceeded our second quarter 2023 guidance ranges for total product and service revenues, non-GAAP EBITDA and non-GAAP EPS. We generated total revenues of $299 million, non-GAAP EBITDA of $47 million and non-GAAP earnings per share of $0.57.

Our better-than-expected performance this quarter was primarily driven by higher technical and advanced services revenues, favorable customer and product mix, and cost management.

Nchacha, who we recently welcomed as Omnicell's CFO, will speak to our financial results and key drivers in more detail during his remarks, as well as walk through the outlook for the second half of the year.

On last quarter's call, we provided an update on the integration of recent acquisitions, ReCept, (now called Omnicell Specialty Pharmacy Services), FDS Amplicare and MarketTouch Media, noting that integration was largely complete. Throughout the second quarter of 2023 we continued to focus on executing our go-to-market strategy for these acquisitions, and we are pleased with the progress we have seen to date.

With this momentum underway and what we believe is a robust portfolio, we find that we remain uniquely positioned to continue to support pharmacy operations across the entire care continuum, delivering mission-critical medication management solutions for our customers globally.

Now turning to the customer landscape and our recent customer wins.

Customers continue to choose Omnicell solutions to maximize clinical and financial outcomes, which we think further demonstrates the important role we're playing in automating and modernizing global medication management infrastructure.

I'll start with customer wins for Advanced Services. Following the successful implementation of Inventory Optimization Service for a group of its hospitals, a major Southern health system is now expanding the service to approximately 20 hospitals across its health system. The customer indicated that its increased need for visibility, insights and analytics for inventory control and cost savings led to the decision to expand this solution. In addition, with the continued challenge of labor shortages, this health system is also seeking insights from the Omnicell platform in an effort to improve pharmacy technician efficiency.

Recognizing the potential value in delivering secure solutions in the pharmacy supply chain, a Florida health system has chosen Omnicell's IV Compounding Service to help it as it seeks to gain better control over medications and decrease reliance on 503B outsourcing. This customer is also expanding its central pharmacy automation footprint with Omnicell carousels, and premium software licenses for their entire fleet of XT automated dispensing systems.

In terms of competitive conversions, a central pharmacy customer in Minnesota has decided to convert their automated dispensing system footprint to Omnicell's XT cabinets, while expanding systemwide pharmacy Inventory Management with Inventory Optimization Service. This combined technology strategy should increase visibility and efficiency, better aligning to the health system's patient safety initiatives.

Furthermore, a current XT customer based in southern California has chosen Omnicell's Specialty Pharmacy Services to support the launch of a health system-owned specialty pharmacy. This customer not only cited Omnicell's deep expertise as a key factor in this decision, but also recognized what it saw as an opportunity for a comprehensive technology strategy to support continued growth across the care continuum.

EnlivenHealth has also reached a significant milestone, entering the Medicaid market with a new medication synchronization partnership with a leading Medicaid plan. The partnership aims to enhance medication adherence among underserved populations by offering personalized support to patients. We are proud of the role Omnicell plays in improving patient health.

And lastly, a northeast pharmacy chain selected EnlivenHealth to support personalized IVR. In just 120 days, the chain saw a notable rise in automated prescription refills, a significant reduction in pharmacy interruptions, and lowered call transfers by approximately 17 percent.

Moving on to the market environment and what we are currently seeing in the overall health care industry. We continue to take what we believe is a prudent approach to managing the business, but, as evidenced by our customer wins this quarter, we are pleased that Omnicell's products, software, and tech-enabled services appear to be resonating with the market.

Our health system customers have faced many challenges in the last few years and are evaluating technology and innovative solutions that are designed to help them achieve their long-term strategic goals.

And with salary cost pressures as well as labor constraints remaining as key challenges for hospitals, we think Omnicell is an important part of the solution. For us, the need to automate, optimize and modernize the medication management process is becoming clearer, which should help ease the pressure on hospitals to implement the services and solutions they purchase at the outset. While these should be long-term tailwinds for Omnicell, we are also seeing some near-term headwinds, as some customers choose to delay adopting new technologies in order to mitigate additional training requirements for their workforces.

As we look ahead to the second half of the year, we expect full year bookings to trend towards the lower end of the full-year guidance range we previously provided due to ongoing capex budget constraints and some of the factors I just outlined. Considering the strong first half performance and solid expense management, we are raising our FY2023 guidance for Total Revenues, non-GAAP EBITDA and non-GAAP Earnings per share. As I mentioned, Nchacha will discuss our guidance in more detail, but long-term trends appear favorable, as we expect customers' need for automation tools and software-enabled services to offset continued pressure driven by labor constraints.

Now, moving on to ESG. At the start of the second quarter, we were pleased to publish our third annual ESG Report. We continue to make progress toward our goal of creating positive change and delivering innovative technologies that are intended to help our customers build a healthier world. This entails designing our products with a view to minimize our environmental footprint while maximizing patient outcomes.

We also continue to support our Diversity, Equity, Inclusion and Belonging initiatives that are intended to foster an engaging and inclusive workplace. Through our ESG efforts, we aim to ensure healthy lives and promote well-being for all.

Before I turn it over to Nchacha to discuss our financial results for the quarter in more detail, I want to note the most recent addition to our Board and speak to some leadership changes.

In July, we were pleased to have Kaushik "Bobby" Ghoshal join our Board as an independent director. As part of Omnicell's ongoing refreshment process, the addition of Bobby expands our Board to ten members. Bobby is an established leader who brings more than 30 years of Global SaaS and Healthcare Technology experience to Omnicell, currently serving as the President of SaaS for ResMed, Inc., and is an important addition to our Board. He has an impressive track record leading high-performance teams in software products, and is responsible for the vision, strategy, and day-to-day operations of ResMed's rapidly expanding SaaS portfolio.

We are also very pleased to have welcomed Nchacha as Omnicell's new CFO at the beginning of June. Nchacha is a seasoned finance and accounting executive with more than 20 years of experience leading and working in global finance organizations across healthcare and consumer products industries. It's been a pleasure to work with Nchacha thus far – he is a commercially focused and collaborative leader and shares our passion for improving patients' health. We find we are already benefiting from his insights, and I know he's looking forward to speaking to some of his priorities with you today.

In addition to welcoming Nchacha, we also announced a number of other organizational changes designed to create a more streamlined organization with a continued focus on operational excellence. This included the appointment of new members to our leadership team as well as a number of promotions within the organization. We believe we have put the right team in place to lead the next phase of our performance as we seek to continue to deliver value for our shareholders, our employees, our healthcare partners and their patients.

With these changes, I want to emphasize that our strategy remains the same – we are simply moving into the next phase of Omnicell's evolution. We believe we must adapt to continue meeting the ever-changing needs of the industry and our customers. This new leadership structure reflects this effort and should enable us to operate more nimbly and further strengthen our position as a leading medication management provider.

We've worked hard to build a strategy that we believe will transform the pharmacy care delivery model globally. Now, we're laser-focused on execution and bringing in people with the right skillsets, that are keenly focused on profitable growth, and I believe we are well positioned for the future.

With that, I'll turn it over to Nchacha to introduce himself and provide further details on our performance and outlook.

Nchacha Etta:

Thank you for the warm welcome, Randy, and thank you to the entire Omnicell team for the support through my onboarding over the last several weeks. I'm excited to be here with you all today, and I am looking forward to meeting many of you in the weeks ahead.

I believe in the Company's mission and vision, and I'm thrilled to be leading Omnicell's finance and IT organizations, which play a key role in enabling the overall strategy and driving operational excellence. Since joining in June, I have been working closely with the executive team and others to enhance Omnicell's mission to continue to be the healthcare providers' most trusted partner for medication management. My time here so far has reaffirmed why I joined Omnicell. Omnicell has a differentiated strategy to transform the pharmacy care delivery model, along with incredibly strong customer relationships and impressive brand recognition. The talented Team here at Omnicell is mission driven and fully committed to improving patient care and ensuring positive healthcare outcomes. These are just a few of the reasons why I believe the Company is well positioned for long-term success.

Now, before I discuss our financial results, I'd like to share with you my immediate priorities in the second half of the year and going forward. First, I intend to leverage data analytics and insights to strengthen our financial performance and improve the predictability of our business. Second, I will seek to ensure that we are strategically deploying capital to support innovation and fuel sustainable profitable growth. And third, I

will continue to ensure we operate with financial discipline as we work toward improving operational efficiency throughout the organization.

I've really enjoyed my first few weeks at Omnicell, and I look forward to working with the team as we move the Company's strategy forward and continue to deliver long-term value to our stakeholders.

Now turning to our financial results.

Our second quarter 2023, Total GAAP revenues were $299 million, an increase of $8 million or 3% over the prior quarter, and a decrease of $32 million or 10% compared to the second quarter of 2022. The year-over-year decrease reflects lower point-of-care revenues primarily as a result of ongoing healthcare systems capital budget constraints. Services revenues were $111 million, an increase of 13% versus the second quarter 2022, primarily driven by growth in Advanced Services.

Total revenues in the quarter were $11 million above the top end of our previously disclosed second quarter 2023 guidance range, primarily due to favorability within technical and advanced services which is not expected to reoccur in the second half of the year.

Non-GAAP gross margin for the second quarter 2023 was 46.8%, an increase of 200 basis points from the prior quarter, primarily due to higher services revenues and the result of our prior cost containment actions. In addition, we saw lower costs for semiconductors, steel, and freight compared to the prior quarter.

A full reconciliation of our GAAP to non-GAAP results are included in our second quarter earnings press release and is posted on our Investor Relations website.

Our second quarter 2023 earnings per share in accordance with GAAP were $0.08 compared to a loss of ($0.33) in the prior quarter and income of $0.20 per share in the second quarter of 2022. This improved performance compared to the first quarter of 2023 reflects the absence of impairment and abandonment charges for operating lease right-of-use assets and other assets; profit from higher revenue, as well as the full benefit of prior cost containment actions.

As we have previously shared with you, sustained GAAP profitability is a key objective for the Company.

Our second quarter 2023 non-GAAP earnings per share were $0.57 compared to $0.39 in the prior quarter and $0.84 in the same period last year.

Our second quarter non-GAAP EBITDA was $47 million, an increase of $20 million compared to the previous quarter and a decrease of $9 million when compared to the same period last year.

Our second quarter 2023 non-GAAP EBITDA and non-GAAP earnings per share exceeded guidance primarily due to higher services revenue, customer and product mix timing within the year and strong cost management. The operational favorability in the second quarter non-GAAP earnings per share was offset by higher than expected second quarter income tax expense.

The impact from the income tax expense reflects timing within the year and is expected to be favorable in the second half of the year.

At the end of the second quarter of 2023, our cash balance was $399 million, up from $340 million as of March 31, 2023.

As of June 30, 2023, we had $418 million of availability under our revolving credit facility and there was no outstanding balance.

In terms of accounts receivable, days sales outstanding for the second quarter of 2023 was 85 days, a decrease of 17 days over the prior quarter, primarily due to strong cash collections as well as timing of invoicing within the quarter.

Inventories as of June 30, 2023, were $131 million, a decrease of $11 million from the prior quarter reflecting continued strong progress our global supply chain team is making on key process improvements and inventory management initiatives.

Free cash flow during the second quarter of 2023 was $58 million driven by strong cash collections.

Now moving on to our full-year and third quarter 2023 guidance. As Randall mentioned earlier, we continue to take a prudent approach to managing the business.

We expect full year bookings for 2023 to trend toward the lower end of the previously provided range of $1.0 billion to $1.1 billion. Customers are showing signs of caution implementing new workflows that stress already stretched nursing and IT labor which is continuing to impact the timing of new capital and software projects.

We are pleased with our strong first half performance, underscoring our solid execution and prudent cost management. Considering the strength in our advanced services and technical services, as well as continued strong execution, we are raising our full-year 2023 Total Revenues to range between $1.160 billion to $1.200 billion, an increase of $10 million from the top and bottom end of our previously provided guidance range.

We are reaffirming our full-year 2023 Product Revenues to range between $740 million to $760 million.

Due to the solid execution in the first half, we are raising our full-year 2023 Service Revenues to range between $420 million to $440 million, an increase of $10 million from the top and bottom end of our initial guidance range.

We expect Advanced Services Revenues to be between $205 million and $215 million, an increase of $5 million from the top and bottom end of our original guidance. This reflects a 13% increase at the midpoint compared to 2022 and approximately 18% of 2023 Total revenues.

We expect technical services revenues to range between $215 million and $225 million in 2023; an increase of $5 million from the top and bottom end of our original guidance. This represents an increase of 6% at the midpoint as compared to 2022.

Please refer to slide number 14 in our earnings presentation published on our Investor Relations website for a summary of the total year revenue guidance components.

We expect total year 2023 non-GAAP EBITDA to range between $130 million and $145 million, an increase of $10 million from the top and bottom end of our initial guidance which reflects the incremental profit from higher expected service revenue for the year and prudent cost management.

We expect 2023 non-GAAP earnings to be between $1.75 and $2.00 per share an increase of $0.20 from the top and bottom end of our initial guidance.

The full year non-GAAP EBITDA and non-GAAP EPS guidance includes the impact of the previously disclosed $50 million of annual Operating Expense savings derived from the recent reductions-in-force and other expense containment efforts primarily within SG&A. We continue to expect 2023 operating expense annual savings will be largely offset by the impact of year over year inflation in employee salaries and increases in expected performance-based compensation, vendor cost increases and investments in R&D.

We expect non-GAAP operating expenses to be flat to down year-over-year.

Included in these numbers is a higher expected blended tax rate in 2023 as result of the increased profit expectations. For full year 2023, we are now assuming an effective blended tax rate of approximately 11% in our non-GAAP earnings per share.

For the third quarter of 2023, we are providing the following guidance:

We expect total third quarter 2023 revenues to range between $290 million and $300 million. We expect product revenues to range between $185 million and $190 million, and service revenues to range between $105 million and $110 million.

We expect third quarter 2023 non-GAAP EBITDA to range between $31 million and $37 million and we expect third quarter 2023 non-GAAP earnings per share to range between $0.42 and $0.52. The third quarter non-GAAP EBITDA and non-GAAP earnings per share guidance includes the expected impact of product and customer mix, and planned investments in innovation and Advanced Services as well as seasonal third quarter expenses. Additionally, the third quarter 2023 non-GAAP earnings per share guidance reflects the income tax timing benefit compared to the second quarter.

In summary, we believe the long-term opportunities for Omnicell are compelling, and we are committed to delivering strong financial and operational performance.

With that we would like to open the call for questions.

QUESTIONS & ANSWERS:

Operator: (Operator Instructions) Your first question comes from Scott Schoenhaus with KeyBanc.

Scott Schoenhaus: Congrats on the very, very strong results and outlook. My first question is really on the operating expense line. Seeing SG&A coming down 17% sequentially from last quarter is a nice operating leverage there. What's driving that? Is that mostly headcount on the point-of-care side? Or is there other cost efficiencies that we should be aware of?

Nchacha Etta: Thank you, Scott. There are definitely other cost efficiencies that you need to be aware of. As we previously announced, a reduction in force and other expense containment efforts, which achieved $50 million of annual operating expense savings. Based on timing, it is reasonable to assume that we saw slightly less than half of the savings in the first half, and we will see the full remaining impact of cost savings in the second half of the year.

Scott Schoenhaus: Great. Just as a follow-up, you mentioned headwinds continuing related to labor environment at the hospitals around nursing and technicians. Do you guys have any expectations for that to improve over the remainder of the year? Or is it built into your guidance, really, just the similar levels of kind of labor issues that we're seeing at hospitals right now?

Nchacha Etta: So while we're seeing incremental improvements as the year progresses, Scott, our health systems are still challenged by continued macroeconomic uncertainty and labor constraints which, of course, are impacting our customers' buying decisions. While Advanced Services, including our technology-enabled solutions, help to drive automation and reduce the need for labor, near-term labor challenges continues to impact our customers' ability to adopt new technologies, which is contributing to our decision to guide towards the lower end of the range.

Randall Lipps: Yes. This labor and concerns about committing to new projects, particularly in Advanced Services where you have more disruption than you would in just ADC business, which is we're not seeing that in that particular area, but mostly in the Advanced Service areas where you've got new robots and new things to install. You need IT and technical people on the organizational side to commit.

Operator: Your next question comes from Allen Lutz with Bank of America.

Allen Lutz: The product revenue was up quarter-over-quarter, and I guess you're kind of guiding for sort of flattish sequentially. But I guess 3 quarters kind of in this range, it seems to me that things have at least bottomed or it doesn't seem like they're getting worse. I guess what are you seeing in the pipeline? Is the pipeline today better than it was 3 months ago, 6 months ago? Just trying to get some perspective on what you're seeing there.

Randall Lipps: Yes. I would have to say that the customers are excited about our products and the pipeline continues to expand. I think it's all about what is the funding timing on these products. And I think we all would have to agree that the modernization in medication management has to take place. There needs to be robots, there needs to be automated software doing these things so that we can run pharmacies at near perfection or get us to the autonomous pharmacy.

So I think the industry has bought into that vision and it's bought there, it's just a question on the timing of that. And so we're engaged as much as we ever have been. It's just the uncertainty about the funding piece.

Allen Lutz: Great. And then a follow-up on Scott's question, Randy, you mentioned the hospital budgetary pressures on new solutions. Can you bifurcate between, I guess, the Enliven product suite, the products that you acquired, and then sort of the products that you've built in-house? Is there a difference in

growth rates between those 2 business lines? Or is there any difference you're seeing with prospective clients on either of those?

Randall Lipps: Well, I think the Enliven is a very exciting area. We've developed a lot of new products. We talked about the go-to-market with the Medicaid product for the Medicaid plan, which I think is very unique for us. And so there's a lot of opportunity there. What's probably more interesting is we're bringing that mostly retail product solution set into our core customers. Because these big provider networks, hospital networks, they want to engage patients in the same way in an outpatient format and even all the way to the home. So they need the same kinds of tool sets that have -- traditionally has been sold in the Enliven environment, which has been to retail pharmacy. So we're really starting to see that crossover begin to happen, and that's the exciting piece.

I think most of the headwinds is not in the retail piece, but it's mostly in these big provider hospitals where nursing and IT people, particularly, are redlining or exhausted. Some pharmacy techs as well. So it's just a matter of time before they get those positions funded and get the relief, and it doesn't know exactly when. I think we're seeing the for-profit hospitals are already probably ahead of the regular market as far as getting better results and getting better alignment on some of those things. But I think the pipeline is strong, and the Enliven product is really an exciting place because -- not just because of what it's doing there, but that we're actually crossing it over into our core product expansion of our marketplace.

Operator: Your next question comes from Stan Berenshteyn with Wells Fargo.

Stan Berenshteyn: A warm welcome to Nchacha. Maybe we can start on booking guidance. I mean you guided lower here on the lower side of the range. Can you maybe just share some details as to what's impacting that? Any particular products or services to call out?

Nchacha Etta: Yes, Stan. Thank you for the warm welcome. Like I mentioned earlier as well as in my prepared remarks, again, our customers are still challenged with labor constraints as well as macroeconomic uncertainty. But we're also seeing some near-term headwinds in Advanced Services, **particularly IV, as customers are navigating a very complex regulatory environment.**

Stan Berenshteyn: Okay. That's helpful.

Randall Lipps: Yes. Just to expand on that a little bit, if I can, Stan, the IV has gone through sort of an FDA filter to get some insights and has gotten made through that. Now it's going through individual states' pharmacy boards to set further regulations or compliance rules. So in some states, it's just going slower than other states, and so that's holding back certainly some decision-making until they understand how that's fully going to be executed.

Stan Berenshteyn: Okay. And then just to square that with guidance. I mean it seems like you're outperforming Advanced Services side, product bookings was reiterated. Maybe if we could just take a step back here. You started the year with about $500 million in short-term backlog. You essentially need $250 million in entry in your bookings to hit that. We're over 50% of the way through the year. What kind

of visibility do you have here? And where are you versus where you thought you'd be at the start of the year?

Randall Lipps: Well, I think we have really strong visibility and we've implemented, particularly on revenue and earnings particularly for the second half of the year because much of it is already scheduled, and we've brought in new processes and disciplines to lock in those -- that visibility. So we feel really strong about that piece as we move forward.

And then I think the part that we're talking about where there's less visibility is when are people going to commit their capital or commit to these new projects. Not necessarily. Some of it may be financial, but a lot of it is when is the organization going to be ready to take on these newer platforms which really require new workflows, new training, or they require IT to go in and spend some time integrating these new platforms into their operation. That's where we see the hesitancy mostly.

Operator: Your next question comes from Matt Hewitt with Craig-Hallum Capital Group.

Matthew Hewitt: It's nice to speak with you, Nchacha. Maybe the first question, there recently was a Supreme Court ruling that prompted CMS to announce a $9 million -- or $9 billion with the B payment to hospitals related to the 340B program. I realize that, that market has been pretty challenged over the past couple of years. But does this change things? And what does that mean for your 340B platform going forward?

Randall Lipps: Well, it probably means that -- a couple of things. We have 2 angles to 340B. One is the 340B where we have contracted pharmacies, and that we have said is relatively flat for this year, $30 million to $35 million. We continue to believe that is what that outcome will be. But it does mean that in our specialty pharmacies where we're spinning up services, remember, it means there are bigger rebates for our customers, which means there's more advantage to deploying our service and it means slightly more revenues for us but not significant in that Specialty Pharmacy Services.

Probably the bigger opportunity, frankly, is the $9 billion rebate which has been a discussion about whether it's going to actually hit 2 hospitals in either Q4 or Q1, no one really knows, is an opportunity for hospitals to spend more money, obviously, on our solution sets. Now I haven't really seen that connection point take place yet where a CFO has said, "Gee, I know I've got this x millions coming in. Now, I'm ready to spend it on this project." My guess is they're going to wait until they get the money in the bank and then decide what to accelerate and the like. But I think that's a big opportunity for us, and it reaffirms that 340B, I think the program to have your own in-house pharmacy, you're going to get richer rebates. You're going back to the old rebate amounts, which were significantly higher in many cases. So that just bolsters that program to be adopted by more people.

Matthew Hewitt: That's great. And maybe one separate question here regarding gross margins, a nice step up here this quarter. I think much of it was on the services side. But when I think back to a year ago, you faced 3 specific challenges: steel, semiconductor chips and transportation costs and gas. It sounds like you got a little bit of benefit this quarter from -- on the semiconductor side and then on the transportation.

As we look at the remainder of this year, are you expecting some further benefits from those 3 areas as you kind of work through either inventory on hand or as the prices for those products come down?

Nchacha Etta: Yes. So as we disclosed during the Q4 2022 prepared remarks, inventories as of December 31, 2022 included approximately $18 million of Advanced Services -- advanced purchases and receipts of semiconductors. The balance was really deeply consistent as of June 30 of this year compared to December 31, and so we believe that also we have some receipts of remaining buybacks that we have committed to purchase to assure continuity of our supply chain.

Operator: Your next question comes from Bill Sutherland with The Benchmark Company.

Bill Sutherland: Welcome, Nchacha. I guess my main question for you at this point might be as you evaluate capital deployment, kind of what's going into your thinking? And what's that process going to be?

Nchacha Etta: Yes. So we will continue to evaluate our capital deployment strategy, and we'll make the right investment decisions to fuel sustainable growth from an innovation standpoint.

Randall Lipps: I think M&A is definitely a long-term strategy that will be there. But I think that Nchacha is looking at the balance sheet, and we definitely have nice cash flows. We've got maybe some debt we need to restructure eventually. And so I don't think it feels like there's anything immediately at this point, but something really to consider as we move forward.

Bill Sutherland: Got it. And then can't have a call this quarter without asking about AI and your -- what your thoughts are as far as implementing that technology across your product set.

Randall Lipps: Well, I think AI has a lot of potentials for many of the obvious areas that many companies are looking at: software development, customer interaction, communications both internally and externally with customers and the ability to gain unique efficiency. So we love the fact that AI is here. We think it eventually will accelerate the ability to get to the autonomous pharmacy sooner, and that's really important to us. But I think it's a little too soon to say where and exactly how those impacts will be, but we have -- AI is on top of our list as we move forward to have specific strategies around specific use cases mostly internal to the company. And we want to be very careful as we use them externally because of just regulatory and proper use of such a powerful tool when we use it outside the 4 walls of the company.

Bill Sutherland: So it's been mostly an internal focus, Randy?

Randall Lipps: I think the first steps are internal, and we may have some proof cases that we may use with certain selected beta customers, but -- and many of our customers, we are very encouraged by them. They are actually leading some of the way on some of these projects and bring us then to them. So I think there's a lot of excitement about solving large, unstructured data questions that can be easily answered. So there's a lot of unstructured data in health care, so lots of opportunities for sure, right?

Bill Sutherland: Right. Okay.

Randall Lipps: Now I just met Bobby Ghoshal from ResMed, and the SaaS is one of the reasons we got him and put him on this Board. He is AI pro and he's helping us think through the process as well, and we've got a lot of resource brought and our team is top-notch. So I just feel like we have lots of opportunities there, but we're not ready to share how that's going to impact us directly, but it's definitely a part of our strategy.

Operator: Your next question comes from David Larsen with BTIG.

David Larsen: It's my understanding that you were increasing prices for your products in 2023. Just any color around that? And are those price increases more than offsetting inflation for semiconductors? And then over what time period should we expect to see these price increases continue to occur? Will they be sort of complete at 12/31/'23?

Nchacha Etta: Yes. So we will continue to assess our price increase strategy. But as we continue to -- we are continuing to see the benefit of pricing actions put in place over our last -- over the last 2 years. We are also seeing modest reduction in cost for semiconductors on freight and steel, which have been subject to significant inflationary pressures on recent periods.

So in the second quarter, for the first time, we saw the benefit of pricing actions outweigh the impact of these inflationary costs, which will modestly be favorable to product and gross margin in the second half.

Randall Lipps: And I'd also add to that, some of our pricing actions in there are -- you can't implement them every -- only for those customers who have renewing service contracts coming up that year can you renew them for. So they're ongoing as we move forward as customers come around, so there are some increases as we move forward. And I think we're -- our strategy is to be prudent about that.

David Larsen: Okay. And then how far along are you in terms of like the XT sort of upgrade process? Are you like 60% of the way through that process? And then it's my understanding that at some point, everybody is going to have to upgrade because you'll sunset support of the more legacy solutions. Is that correct or not? And then once you do get through these XT upgrades, won't there simply be another version of the Automated Dispensing Cabinets that you sort of bring to market, and there will be a whole new cycle that starts? Just any thoughts or color there would be very helpful.

Randall Lipps: Yes. We are significantly way through the XT upgrade. It's well over 60%. And we don't believe that the whole 100% of the market is even going to convert. So we're getting towards the end of that, but we continue to add on with what we call expansions, which is a big part of our XT business as well as competitive conversions.

We usually have a 10-year life cycle to our systems and we generally cycle new products. On that, I believe, we started in 2017. We don't time it exactly with those days, but certainly, we have to continue to upgrade our hardware to take on new software solutions and really looking to add more value, create more value for our customers. And so you're right in assuming that we don't have any time lines to talk about. But you're right, we do have product cycles that we traditionally do, and we're nearing the end of the XT.

David Larsen: Great. And then just one last quick one, if I can squeeze it in. Did I hear you say, Randy, that the $9 billion from CMS will be paid in 4Q of '23 and 1Q of '24?

Randall Lipps: There hasn't been -- it's still up for grabs, whether it's Q1 or Q4 of this year. But as far as my current understanding and -- is that it will be a lump sum and it will be in Q4 and Q1, just coming up Q4 or Q1 of the new year. And those extra dollars, I think, are waiting to be seen by these hospitals, I think, to be sure of what those states are, but I think that will have an impact on the ability to spend money.

Operator: Your next question comes from Jessica Tassan with Piper Sandler.

Jessica Tassan: Congrats to Nchacha on the start date. So I think my first question is just on product gross margin. Those have been kind of moving around quite a bit in the last couple of quarters. I'm hoping you guys can describe the structure of product cost of goods, maybe the mix between fixed and variable. And just what you would expect for normalized product gross margins. Like where should they be trending '24, '25?

Nchacha Etta: Thank you, Jessica. So we really cannot comment on 2024, 2025, but I will tell you that in 2023, the key drivers of our gross margin were higher services revenue, favorable customer and product mix as well as the full impact of cost containment actions that we took last year.

Jessica Tassan: Got it. So just -- I guess we're trying to understand, right, the impact of incremental product revenue on the product gross margin. So can you help us maybe understand the mix between fixed versus variable cost of goods within product gross margin?

Nchacha Etta: The mix is really primarily between, again, like I said, customer and product mix as well as higher services revenue.

Jessica Tassan: Okay. Got it. So maybe for Randy, is the Medicaid deal that you mentioned the first payer deal within EnlivenHealth? And if so, can you just help us understand kind of the context for that deal and maybe the pricing? Does Omnicell have any exposure to outcomes or any sort of value-based components of that deal?

Randall Lipps: Well, it's always somewhat outcomes driven as the medication synchronization is based on signing up customers and keeping them synced up to the regular use of their medication management. And that's around a plan that's more holistic that is, they are the provider and the pharmacy, if you -- so to speak. So I think that's the unique opportunity that came here to come outside of what I would call the retail customer base, to be inside of a plan where you see more of this engagement directly with the patient in order to get better outcomes. And we know it's really hard to service the Medicaid market.

So I think we're really excited about that. I think there were -- I feel like we're the only company doing these kinds of things, that are really making the difference at these multiple levels and multiple market

penetration points. Because of these services are so uniquely put together, it can be formulated if you have a good patient interaction scenario to go after. And certainly, this is one that fits well with us.

Jessica Tassan: Got it. And my last question is just you guys beat the high end of services revenue guidance now 2 quarters in a row. So is that upside relative to the high end of guidance coming from better-than-expected implementation? And if that's the case, just why wouldn't that strength persist in the second half when the operating environment is arguably going to get better for hospitals and you potentially have this $9 billion remuneration payment hitting in 4Q?

Nchacha Etta: Yes. Services revenue is expected to be approximately flat due to the strong performance that we saw in Q2, primarily from the favorability in timing of revenues which is driven by technical services renewal timing as well as Advanced Services, which we do not expect to reoccur in Q3 and the second half of this year.

Randall Lipps: We just had a lot of renewals in Q2, and sometimes those renewals come with back payments for a few months they hadn't paid for, and so you get an extra few payments there. And so a lot of that happens in Q1 and Q2. It doesn't happen as often in Q3 and Q4.

Operator: There are no further questions at this time.

I will now turn the call back over to Omnicell's Chairman, President, CEO and Founder, Randall Lipps.

Randall Lipps: Well, I'd really like to thank the Omnicell team for delivering a solid quarter, getting us, I would say, back on track. The new management team, particularly having Nchacha join us, he's been such a great help to us getting our head straight and moving the company forward.

And I just -- it's just an exciting time for innovation, exciting time for our customers to deploy these new products and get back to this predictable, profitable, scalable growth infused with great ambition.

So thanks for being here.

And we'll see you next time.

Operator: This concludes today's conference call. You may now disconnect.