TITLE: Q3 Earnings Call
CUSTOMER: InfuSystem Holdings, Inc. - Webcast Events
CONFIRMATION NUMBER: 38393591
HOST: Jonathan Foster
DATE: November 10, 2014
TIME/TIME ZONE: 9:00 am Eastern Time

Operator: *Good morning, everyone, and welcome to the InfuSystem Holdings Third Quarter 2014 Conference Call. This is your operator, Paulette.*

Let me first give you to Mr. Jonathan P. Foster, Chief Financial Officer.

Jonathan P. Foster: Good morning, everyone. First of all let me get some administrative matters out of the way. The Company issued a press release this morning. The release is available on most financial websites. Additionally, a Web replay will be available on the Company's website for 30 days. Both the press release and Form 8-K and the Company's Form 10-Q for the third quarter of 2014 have been filed with the SEC this morning.

During the course of these - - this earnings call, the Company will make projections and other forward-looking statements. A detailed discussion of the risk and uncertainties that could cause the Company's actual results to differ materially from those in any forward-looking statements can be found in InfuSystem's SEC filings, particularly the risk factors including our most recent 10-K, and is updated in our quarterly reports, including our 10-Q filed this morning. The Company's projections and forward-looking statements are based on factors are subject to change and therefore speak only as of the date they are made. The Company has no obligation to update any forward-looking statements made during this earnings call. The Company will refer to certain non-GAAP measures, such as adjusted EBITDA which is not considered a measure of financial performance under GAAP, the reconciliation of the differences between non-GAAP financial measures, and the most comparable GAAP measures contained in the

Company's press release issued this morning.

With that, I'd like to turn the call over to Mr. Eric Steen, Chief Executive Officer.

Eric K. Steen: Good morning, everyone, and thank you for joining the InfuSystem Holdings, Inc., Third Quarter of 2014 Earnings Call. Joining me today are Jan Skonieczny, Chief Operating Officer, and John Foster, Chief Financial Officer.

For our recent quarter, I'm pleased with the accomplishments of my team, especially in the area of information technology development. I'm encouraged by the continued growth of both our provider and supplier business segments, and I'm thrilled about the outstanding patient satisfaction scores we are getting from both our oncology and postsurgical pain patients and what that will mean for our future.

Before I talk in more detail on these matters, let me first discuss our Q3 financial results. Revenues in the third quarter were $16.6 million, up 6 percent from the third quarter of 2013. Revenue for the first nine months is up 11 percent versus prior year. Gross profit for the second quarter is $11.7 million, up 3 percent from prior year. The gross profit percentage was 71 percent in Q3. For the first nine months of the year, gross profit dollars are up 11 percent versus 2013. Net income was $900,000 in the third quarter, or $0.04 per share. Year-to-date, net income is $2.3 million, or $0.10 a share. This compares to $0.04 per share in the first nine months of 2013.

Now I'd like to talk about what the team has accomplished. We are spending money for our future, and I want our shareholders to know what they are getting for this investment. For our key strategic tenant of electronic connectivity, we now have 25 oncology infusion centers connected with our state-of-the-art, not only paperless but order entry free, electronic medical record integration. In 2013, we had zero. We are now connected with EMR software systems like Epic, Altos, and Varian, with several new EMR vendors connecting with us in the coming months. As a result of our electronic connectivity efforts, we are

receiving over 40 percent of our third party payer orders electronically through our paperless ordering systems. The EMR connectivity investment will help us to gain share, process claims more quickly, not losing revenue to exceed in claim filing limitations, and process more claims without increasing staff in our billing department. We already have an annualized $1.6 million of new oncology business in our pipeline as a result of EMR connectivity.

Our recently launched pump Web portal that helps both our customers and our internal operations manage the care and lifecycle of infusion pumps now has thousands of pumps per month being monitored. We now have the data from hundreds of postsurgical pain patients and their pain satisfaction scores for our orthopedic surgery customers so they can track and trend clinical information that positions them to meet their hospital consumer assessment of healthcare provider and systems, or HCAHPS, scores to receive increased reimbursement amounts from Medicare.

In the third quarter, we also launched our new website and have all the legacy InfuSystem provider business, the legacy first biomedical supplier business, our new pain management service, a convenient online payment mechanism for our payments, and our increasing line of infusion disposable and safety products combined into one site.

We also launched a new asset management software called InfuTrack which offers both inventory management and asset tracking. It features an asset retrieval process interfaced directly to carriers like FedEx and UPS. It has dashboard reporting and interfaces directly to our pump portal. We will be utilizing the system internally for improved asset management of our own pumps and we are working with data site customers in hospital, home infusion, and specialty pharmacy.

With EMR integration, pump portal, new website, Infu(inaudible) asset tracking, and Block Pain Dashboard, we had five information technology development projects going on at once. A tall order for a small company, but speed to market is important to me and I elected to spend the money necessary to

get all of these worthy projects to the marketplace as soon as possible. It is a time with change in the market and a time of change is the time to gain share and these value added software programs are important as we transition from a pump company to a company with value added software that helps our clients use our pumps more effectively and efficiently. Making this investment has impacted our short-term results, most notably our adjusted EBITDA which is up $200,000 over prior year and without the expense and pain in IT, it would be close to a million dollars. We've also brought some capabilities in-house, including legal with the hiring of Sean Schembri as general counsel. In addition, tax and internal auditing positions have been brought inside. Due to recruiting and onboarding, these expense areas are slightly higher in the short-term, but I expect significant savings and increased capabilities for the long-term.

We continue to grow in all business areas - rentals, equipment sales and service, and sales of disposable products. We made a significant investment of $3.7 million in our pump fleet for the first nine months of the year, an increase of $800,000 compared to 2.9 million in the first nine months of prior year. This investment allows us to serve our increasing pain and oncology patient populations plus the increase in rentals to our provider customers.

In the third quarter, our provider business patient census and gross billings were up 5 percent, but our collected revenue was down 2 percent. The cause of this upside down equation is primarily the impact of the Affordable Care Act. In 2014, we have seen a lot of patients changing insurance plans in mid-treatment. Many small employers have turned away from offering health plans as they view the Affordable Care Act Exchange Marketplace as being more cost effective. What this means for InfuSystem is we need more contracts with the new exchange and Medicaid plans. To address this, Jan has hired a payer expert, Steve Marcus, who has over 25 years of experience at large integrated health networks. Steve has more experience dealing with Medicaid and other types of plans than we previously had at InfuSystem. Steve and his team are actively pursuing contracts where we are non-contracted with a focus on the new exchange plans.

Speaking of payers, CMS released "The Final Rule" that implements the Affordable Care Act mandate to use competitive bidding rates for adjusting durable medical equipment fee schedule payment amounts. As I said in my first InfuSystem earnings call 18 months ago, I believe that competitive bidding will help InfuSystem in the long-term by further consolidating the market and allowing us to gain share as we implement an electronic connectivity and IT development strategy that will drive cost from our processes and allow us to maintain margins.

With that, I would like to ask Jan Skonieczny to please give us an update on the competitive bidding final rule. Jan.

Janet Skonieczny: Thank you, Eric. CMS continues to be an active subject. On October 31st, 2014, CMS released a final rule entitled *End-Stage Renal Disease Prospective Payment System, Quality Incentive Program, and Durable Medical Equipment, Prosthetics, Orthotics, and Supplies,* or more simply *The Final Rule.* This lengthy final rule was published in the Federal Register on November 6th, 2014, and, as you can imagine, it has taken some time to digest. The rule finalizes several provisions relating to durable medical equipment, prosthetics, orthotics, and supplies, or DMEPOS, which include items and services to subject to competitive bid placing in 10 or fewer competitive bidding areas, or CBAs, will subject to payment reductions where single payment amounts, or SPAs, will be equal to 100 - - 110 percent, excuse me, of the unweighted average of single payment amounts in those areas outside of the current CBA. This includes the category for external infusion pumps and supplies. Such adjustments would apply in non-CBAs for items furnished on or after January 1st, 2016. CMS has adopted a six-month phase in of these adjustments to the payment amount. For items and services with dates of service from January 1st, 2016, through June 30th, 2016, the fee schedule amounts in non-CBAs will be based on 50 percent of the unadjusted fee schedule amount and 50 percent of the adjusted fee schedule amount. Then beginning on July 1st, 2016, the fully adjusted payment rates will apply.

So what does this mean to InfuSystem? Based on our current mix of revenues and current fee schedules, we estimate that this new rule could reduce revenues in the range of 1 to 2 million dollars in 2016 and 2 to 3 million in 2017. We believe that with our focus on improving our commercial contracts, along with operational and IT improvements, that we could potentially offset some, if not all, of these reductions by these years.

Eric.

Eric K. Steen: Thanks for that update, Jan. It will be interesting to watch this process unfold. In other areas, our pain management service continues to grow in both acute care and outpatient surgery centers. Block Pain Dashboard gives hospitals and surgery centers the ability to receive patient satisfaction scores to meet their HCAHPS requirements which will enhance their reimbursement from CMS Medicare. It is a long sales cycle that often requires input from a complex web of decision makers, both clinical and financial. But the good news is once implemented, our pain management customers love it. The churn of business in Q3 was the least favorable since I've been here. It was compounded by one of our major suppliers deciding to end-of-life one of the ambulatory pumps in the marketplace. This doesn't happen very often, but when it does it takes a lot of energy and expense to swap everything out. It is expensive when you own thousands of well depreciated pumps generating revenue and then you have to buy new pumps and start the depreciation process all over again.

The most encouraging aspect of our third quarter is not the accomplishments of our hardworking IT team or the growth of patients, it is the off-the-chart patient satisfaction scores and what that means to our future. In our Affordable Care Act future, patients will become increasingly important decision makers. The outstanding patient satisfaction scores and patient pain scores gives me confidence that we are on the right track. Patients are never more satisfied as when they receive their care in the comfort of their home. The most affordable site of care. As the number of home infusion patients grow, InfuSystem will be well positioned in both our provider business and supplier business. An important development in home

infusion is the recent introduction in the U.S. House of Representatives of the Medicare Site of Care Act, which will expand the number of home infusion therapies that Medicare reimburses for and will allow our nation's senior citizens to have the same coverage as the commercial insurers provide. Approval of the Site of Care Act will provide valuable cost savings at a time when the Medicare program needs them by reducing the number of expensive hospital and skilled nursing facility omissions and protecting our senior citizens from the increased risk of contracting infections that comes with nursing home and hospital stays.

Now I'd like to ask John Foster to take us through the numbers.

Jonathan P. Foster: Thank you, Eric. First of all, let me provide some summary financial comments. On revenue, we are focused on continuing to grow recurring rental revenue. These revenues traditionally have greater contribution margins than sales. Our broker dealer desk has been quite successful in generating sales year round. Reducing our sales seasonality, I believe this is a new paradigm for InfuSystem. As Jan has stated before in conversations here in Infu, this is not here first rodeo. I think the same for InfuSystem. As we saw in this past quarter and year-to-date with the impact of the Affordable Care Act becoming clear on our payer mix, the transitioning of end-of-life pumps, the first this has occurred in years if not in a decade, the plan increases in IT and for pain management of a half million dollars along with the unplanned charges of a half million, we're able to balance this along with our single digit annual revenue growth target and maintain strong year-to-date adjusted EBITDA (inaudible). Lowering net debt balances and our cost of debt, however, remains a priority, second to supporting growth and revenue, especially our recurring rental revenue base. Lastly, on the recent news from CMS, in 2009, InfuSystem revenues were primarily based on oncology pump rentals with approximately over 30 percent of our total revenues from CMS. Today that approximate percentage is less than 25 percent. This reduction is due to the growth in other revenues outpacing the growth in the revenues associated with oncology treatment. This trend continues.

Now I'll discuss the financial results for the third quarter and year-to-date. Our net revenue for the quarter ended to September 30, 2014, was $16.6 million, an increase of $0.9 million, or 6 percent, compared to $15.7 million for the quarter ended to September 30, 2013. During the period, net revenues from rentals were constant, while net revenues from product sales increased $0.9 million, or 69 percent, over the same period in 2013. The increase in net revenues was primarily related to the addition of larger customers and increased penetration into existing customer accounts being offset by a higher mix of Medicaid and patient payers in our rental business, which generally have lower net revenue rates than commercial payers. Such shifts have come, we believe, due to the Affordable Care Act. Revenue for the nine months ended September 30, 2014, was 50.2 million, an increase of $5.1 million over the same prior year period. During this year-to-date period, net revenues from rentals were up $2.6 million while net revenues from product sales increased $2.5 million over the same period.

Gross profit for the quarter ended September 30, 2014, was $11.7 million, an increase of 0.4 million, or 3 percent, compared to gross profit of 11.3 million for the quarter ended September 30, 2013. Gross profit as a percentage of revenues represented 71 percent and 72 percent for the three months ended September 30, 2014 and 2013 respectively. The decrease in gross profit as a percentage of revenues for the period is mainly due to the increase in product sales compared to rentals, which generally have a gross margin rate. Gross profit for the nine months ended September 30, 2014, was up $3.6 million, or 11 percent, compared to the same prior year period. Gross profit as a percentage of revenues represented 71 percent for the nine months ended September 30, 2014 and 2013 respectively.

Provision for doubtful accounts for the quarter ended for the third quarter was $1.3 million, a decrease of 0.5 million, or 29 percent, compared to $1.8 million for the quarter ended September 30, 2015 *[sic]*. The provision for doubtful accounts was 8 percent of revenues at September 30, 2014, down from 11 percent for the same period in the prior year. This decrease during the quarter is a result of our focus on patient collections, a focus we have discussed for some time and knew would take time to see results. We believe that the second quarter would be the high watermark and we're excited that we saw such a

decrease in the third quarter. Provision for doubtful accounts for the nine months ended September 30, 2014, was 4.8 million, consistent with the same prior year period. The provision for doubtful accounts was 10 percent of revenue at September 30, 2014, compared to 11 percent of revenue for the same prior year period.

During the quarter ended September 30, 2014, selling and marketing expenses were $2.5 million, an increase of 0.1 million or 4 percent, compared to $2.4 million for the quarter ended September 30, 2013. Selling and marketing expenses for the nine months ended September 30, 2014, were 7.8 million compared to $7.3 million for the same prior year period, an increase of 0.5 million or 7 percent. These increases were largely attributable to increased commissions based on higher revenue for the comparable periods. As a percentage of revenues, we're seeing some year-to-date leverage as selling is a lower percentage of revenues, 15.4 percent versus 16.1 percent last year.

During the quarter ended September 30, 2014, our general and administrative, or G&A, expenses were $4.9 million, which is slightly up from the $4.6 million for the quarter ended September 30, 2014. The increase in G&A expense versus the same prior year period was mainly attributed to increases in spending on information technology and pain management initiatives of $0.2 million, charge-offs (inaudible) 0.1, and increases in compensation and headcount for $0.5 million, offset by savings in professional fees of 0.4 million. The Company has brought some services in-house previously performed by outside contractors, including tax, legal, information technology, and internal audit. G&A expenses for the nine months ended September 30, 2014, were 14.7 million compared to 14.6 million for the same prior year period. The slight increase in G&A expense versus the same prior year period was mainly attributed to increases in spending on IT and pain management were half million dollars, a write-off of pumps of 0.3 million, severance of 0.2 million, an increase in compensation, and benefits including increased headcount of 0.9 million all offset by savings of $1.2 million in professional fees and $0.4 million in stock-based compensation.

During the quarter ended September 30, 2014, we reported income tax expense of $0.8 million compared to tax expense of 0.4 million during the quarter ended September 30, 2013. During the nine months ended in September 30, 2014, income tax expense was 1.9 million compared to 0.3 million in the same prior year period. The increase in income tax expense is primarily due to increased profitability during the quarter and year-to-date periods. This effective tax rate of 45.1 percent was higher than the U.S. federal tax rate, primarily due to the impact of state and local taxes and income tax on the Company's Canadian operation. The impact of state tax and Canadian (inaudible) attributable to the growth of our business in areas where we do not have any NOLs.

As of September 30, 2014, we had cash or cash equivalents of 1.9 million and $3.6 million of net availability on the revolver compared to 1.1 million of cash or cash equivalents and $5.9 million of availability under the revolver as of December 31, 2013. Cash provided by operating activities for the nine months ended September 30, 2014, was 4.2 million compared to 4.8 million for the nine months ended September 30, 2013. The decrease in cash is due to the cash flow effects of the change in accounts payable and other accruals. Cash used in investing activities was 2.0 million for the nine months ended September 30, 2014, compared to $0.6 million for the nine months ended September 30, 2013. The increase in cash used was due to a $3.2 million increase in spending on non-pump assets, which was a direct result of significant ongoing investment in information technology and the preparation of new facility in Kansas and (inaudible). Offset by a decrease in cash used of 0.7 million related to proceeds from medical equipment sold. Cash used in financing activities for the nine months ended September 30, 2014, was 1.5 million compared to 5.6 million for the nine months ended September 30, 2013. This change is primarily attributable to our decision to pay off multiple old capital leases in 2013 whereas this year we've made the required principal payments on all outstanding leases and bank debt.

Our availability in the future will be impacted, both negatively and positively, at different times as we deal with transitioning of approximately 2,000 pumps that are nearing end-of-life in May of 2015 with a certain manufacturer. For the nine months ended September 30, 2014, this results in additional capital purchases

of $1.9 million. Not all of these pumps will need to be replaced as we are focused on and have already improved upon increased field utilization. As we take advantage of rebate programs offered by many manufacturers of this certain pump, additional purchases will incur but at a discounted rate. At this time, we do not believe that this transition will negatively impact our results of operation as current rebate - - as current rebates exceed the net book value of these pumps.

Comparing our net - - our working capital days as of June 30, 2014 to this time last year, we ended the quarter with accounts receivable days outstanding, or DSO, of 62 days, slightly higher than this time last year of 53 days and up slightly from the last fiscal quarter of 59 days. The increase in DSO was due to more billings coming later in the quarter than this time last year or the previous period. Our day sales and inventory, including our medical equipment held for sale or rental, or DSI, decreased from 25 days for last year's Q3 to 21, reflecting the success of our broker dealer trade desk. Day sales and accounts payable remain constant with prior year's Q3 of 25 days. Overall networking capital days of 59 was up from Q3 of last year of 53. One of the efficiency measures that I've mentioned in prior calls is our turnover ratio or I've sometimes referred to it our rental (inaudible) ratio. Taking just our rental revenue, our medical equipment and rental service at historical cost, the ratio in the current quarter was 1.47 adjusted for the end-of-life pumps compared to the year ago quarter of 1.57 and the previous quarter of 1.50 on an annualized basis. The decrease in this ratio reflects recent purchases of our rental fleet required to serve current and future rental customers. An increase in our overall fleet as we look to increase our customer service levels by increasing (inaudible) levels at our service centers and impact on revenues of the ACA as I previously discussed. (Inaudible) we're seeing a significant increase in our utilization in the field in our oncology business.

And with that, I'll turn it back over to Eric.

Eric K. Steen: Thanks, John. Going forward, our investment and accomplishments in information technology will continue to fuel growth, generating the cash necessary to pay down debt. Our patient

growth and revenue growth will continue, but profit remains the focus. We're not going to be chasing any big revenue low profit deals and will we not be cannibalizing any of our long-term rental business just because we had a huge onetime broker sale in the fourth quarter of 2013. That said, I'm continuing our guidance of high single digit growth through the end of 2015.

With that, I'd like to open up the lines for any questions that you may have.

Operator: *Thank you. We will now begin the question-and-answer session. If you have a question, please press star then one on your touchtone phone. If you wish to be removed from the queue, please press the pound sign or the hash key. If you are using a speakerphone, you may need to pick up the handset first before pressing the numbers. Once again, if you have a question, please press star then one on your touchtone phone.*

And our first question comes from Joe Munda from Sidoti & Company. Please go ahead.

Joe Munda: Good morning, guys. Thanks for taking the questions. Can you hear me okay?

Jonathan P. Foster: Good morning, Joe.

Joe Munda: First off, I'd like to touch on the rental business. John, Eric, it seems like revenues there kind of stagnating through the last couple of consecutive quarters. Can we talk a little bit about what's going on there? I know you touched on a little bit of the mix as far as Medicare is concerned, but I mean is this a new ceiling for the Company and how does the impact of these end-of-life pumps really impact that rental business going forward? Thank you.

Eric K. Steen: Yeah, Joe, the rental business, I talked a bit about it. We've had three consecutive quarters of increased patient growth. But as I said this last quarter, our patient growth in the third party

payer business grew 5 percent, but revenue collections were down 2 percent. The Affordable Care Act did create I'd say new challenges for the Company. A lot of Americans changed insurance plan. We're not electronic yet. The business I inherited, that was a fax machine business. Although we're making progress in getting 40 percent of our business electronically, there's still a lot of paper shuffling. And when patients are changing insurance plans, it - - we've got to catch up to them. The… It's not a new ceiling. No way. One thing we've learned a lot about, Medicaid plans and exchange plans that in the past weren't as important to InfuSystem, and that's what I talked about. Jan has a new hirer, Steve Marcus, that I'm very impressed with and there are buckets of money out there that we're not capping. I call Steve the rainmaker because I know he's going to make it rain and there are considerable amounts of money that with his contracting expertise, we're going to harvest more money. So the Affordable Care Act was implemented once and it was - - it created a lot of new challenges, which I think we've met in a good way, but we need to do better.

And then the… Now I'll switch and talk recently about the end-of-life. I've been in the infusion business most of my life, over 30 years, and there's not that many pumps that get end-of-life in the U.S. market. The… I think the most popular pump in the United States today is a pump that I sold when I was a boy sales rep. It's still in the marketplace. But I would say with some increased FDA scrutiny, one of the manufacturers decided to end-of-life an ambulatory pump that we had thousands in the marketplace. And when you have thousands of pumps out there and many of them well depreciated, generated revenue. When you have to go to take the effort of swapping out pumps, the sales reps are involved. They're not selling new accounts. They're working on business we already have, so it takes a little - - takes a little bit of steam out of it, but we've got behind us for the most part. We've taken those pumps and got in trade-in value and upgraded and enhanced our fleet. I always like to say it's a good news or bad news. Perhaps some of the new pumps we have will allow us to go to accounts that aren't on the InfuSystem model yet and attract even more clients. Although I think longer-term, electronic medical record is going to be the real thing combined with competitive bidding. This market's consolidating and we will consolidate further

and we're the market leader, so I think some of these things that done look like good news in the short-term will be in the long-term position us to be successful.

Jonathan P. Foster: If I may add to that, Eric. In our rental revenue base, as Eric mentioned in the call, in our oncology business, our base business is up. The number of patients we're serving is up. The Affordable Care Act is impacting that. With the investments we've made in IT, we can now focus on the profitability and the net cash collected by facility, by payer, which now gives Stave Marcus's, as Eric mentioned, the tools he needs to know exactly which plans will benefit the Company the most and of course he can prioritize which plans he's working on in the exchange. That is the granular part of why we're so focused and also, to be quite honest, excited about Steve that he now has the tools to know where he needs to go to work. Within that rental number, also - - we also have direct pay rental, where we're renting directly to the facilities, and that base business is up. Why it looks a little bit flat, as we mentioned, is the ACA, and I think we'll solve that as we move forward with Steve. From a standpoint of, as Eric has talked about, on the end-of-life pumps, from a - - there is - - there's no quality issue of care to the patient. From a financial - - from a P&L point of view, it's not going to have any impact. It was just basically purely a cash flow liquidity and buying and selling those pumps. Right now our net book value is greatly less than the rebates being offered and so it's just going to be probably a six-month to a year timeframe as we digest those pumps and pull them out of service with our customers because we currently have a quite a number, over quite - - much more than a thousand of these pumps still out at customers being used and they're very happy and so we'll have to transition as we move forward.

Joe Munda: I'm sorry, so what exactly - - I mean so we expecting a material impact to gross margin? I mean is gross margin going to…

Jonathan P. Foster: No.

Joe Munda: It's still going to be (inaudible)…

Jonathan P. Foster: But you got to remember, when we're talking 2,000 pumps, this is out of our rental fleet of over 40,000.

Joe Munda: Okay, that's helpful. **As far as these… As far as the pump sales are concerned, it's very all over the place. One quarter it's a million two. One quarter… Now it's 2.1. I mean how should we look at pump sales for modeling purposes going forward? Are we expected to have it be a million to 2 million quarterly going forward let's say through 2016? How should we look at that?**

Eric K. Steen: I think the - - you should look at pump sales. The big 1.2 million sale we had, that was a onetime event. Could it happen again? Yeah. When will it happen again? I don't know. It's… There are opportunistic things based on demands in the marketplace and peaks and swings in the marketplace. That's a business that's a patient business, no pun intended. You got to have patients to see opportunities to buy pumps in the marketplace that you think will be of greater value downstream and so that's our core business is a focus on recurring revenue. Rentals, leases, disposable sales, that's our focus. But if we see opportunities to have a big onetime sale, that's all we need to do.

Joe Munda: Okay, that's helpful. **Eric, you talk about pain management and the push there. Can you give some color? I mean did you guys book any revenue from pumps that were utilized during pain management in the quarter and, if so, can you give us some indication of possibly percentage of revenue?**

Eric K. Steen: We did book revenue for pain patients in the quarter and we booked revenue for pain patients in every quarter. Currently we have two models that we bill hospitals for pain. We have both a provider model where we're collecting from insurance and we also have a supplier model where we're doing rentals to directly to our surgery center or hospital customers. We haven't reported that number directly and it's blended in and at this point I'm not as focused on it. What I'm really focused on is getting

the patients and the reference accounts and getting the patient population growing and at some point downstream I'll get more interested in what the revenue is. But right now, my mind is just on growing the concept and growing - - improving the model.

Joe Munda: Okay, and then I guess my final questio**n: As far as the CapEx is concerned, you talked about 3.7 million being used for pump purchases. I'm showing 7.2 through nine months. Can you fill us in on where the gap is between 7.2 and the 3.7 you guys talk about for pump purchases?**

Jonathan P. Foster: Yeah, Joe, this relates back to the change in our cash flow statement back for yearend 2012 that we went through and other people in the industry went through as well with Apria. That $7.2 million includes pumps that are sold through cost of sell as well, so they include not only what you would call CapEx pumps but cost of goods sold pumps. That's a new requirement from - - by GAAP that we look at it that way. So the net cash used in investing activities net/net would be after CapEx and your change in inventory, but that's just a requirement that kind of came down upon us and others in the industry in 2012. So that's why we try to let you - - the best way for you to understand what's happening in our pump fleet is going back to the footnotes on - - footnote number two, medical equipment and property, and that's why we add it at that time. The detail on a historical cost basis of our medical equipment and rental service is to help people understand what we've exactly done with our medical fleet.

Joe Munda: Okay, thanks, guys.

Jonathan P. Foster: Sure thing, Joe.

Operator: *And our next question comes from Brooks O'Neil from Dougherty & Company. Please go ahead.*

Brooks O'Neil: Good morning. **I was hoping, Eric, you might just talk a little bit more about what it is you're doing to drive those really strong patient satisfaction scores.**

Eric K. Steen: Yeah, I would say the - - there's two things. The first thing is on our pain program where we've got a nice offering that utilizes the electromechanical pumps to follow patients after orthopedic surgery home with a pump instead of having oral narcotics. We actually in addition to the pain scores we collect, we have these little postcards we give the patients that say, "Tell us what you think." Now I have some of these postcards saved where patients have handwritten in saying, "This is my second knee surgery. The first one I was given oral narcotics and made me sick and I was sleepy and I couldn't do things. Now I went home and I did a conference call from work after my surgery. Thank you, InfuSystem. This has really made a difference in my life." So I think a lot of it's the pain scores. And then I think on oncology, it's a - - for our oncology patients, it's a changing world. There's higher patient co-pays and deductibles that patients have to make, so our patient revenues have increased. But one of the situations is sometimes a cancer patient might be the breadwinner for the family and now we - - we're still a compassionate company and we need to work with people and in some cases we've got them on payment plans and I think the patients appreciate that how we've worked with them in their near plans and so our patient satisfaction scores are very high. And I've been in this business for 36 years and one thing I've learned is that if you put the patient at the top of your organization chart, the rest of the stuff unfolds as it should, and I think the combination of both our clinical and financial treatment of our patients is what is driving our patient scores to be the highest in our segment.

Brooks O'Neil: That's great. **So I was just curious about the other thing you talked about or one of other thing you talked about, which is the site of service opportunity with Medicare. Could you just talk a little bit more about how significant an opportunity you see that and sort of what you think the timing might be?**

Eric K. Steen: Yeah, I think I can do the opportunity better than the timing, but thank you for the question. It's something I love talking about. Reimbursement is changing and we're going away from fee-for-service and the insurers, including Medicare, are giving different objectives for hospitals or home cares to meet and one of the big changes I talked about was the healthcare consumer surveys. In the industry, people refer to them as HCAHPS, and HCAHPS scores will drive reimbursement rates. And one of the areas that's important in HCAHPS are patients' pain scores and patients' satisfaction with pain and so I mention the IT expenditures that we've done to come up with our product that's called Block Pain Dashboard. And so for all the patients that go home on our pain management service, we're calling those patients and we're collecting their scores and we call them immediately after surgery. When they first get home, we call them to follow-up, and it's obvious from the comments we're getting back, the patients like it. They like the fact that someone's following-up on them and the electromechanical pumps are a better clinical option than either the disposable (inaudible) pumps or the oral narcotics. I mean there've been so many stories in the media on oral narcotics. I don't think I need to go on about why oral narcotics are not a good choice, but peripheral nerve block is. Peripheral nerve block is part of regional anesthesia, regional anesthesia continues to grow. Continuous peripheral nerve block at home continues to grow. And with Block Pain Dashboard, we can now go to a hospital and say, "Not only can we save you money, but we're going to give you a tool that's going to help you increase your revenue." And on the timing of when hospitals will all have programs in place to be able to address it, I'm not sure about that, but I know that the forward-thinking hospitals are looking at that and we find customers who see our product offering, our value-added software Block Pain Dashboard and they are so happy to run to administration so they can be the hero that helped the hospital position for increased reimbursement.

Brooks O'Neil: That's great. Thank you very much.

Eric K. Steen: Thanks for the questions, Brooks.

Operator: *Once again, if you have a question, please press star/one on your touch-tone phone.*

And our next question comes from Doug Weiss from DSW Investments. Please go ahead.

Doug Weiss: Hey, good morning.

Jonathan P. Foster: Good morning, Doug.

Doug Weiss: **So I just wanted to clarify a little bit on the census on the private pay, 5 percent census growth but 2 percent revenue decline, how much of that is - - when you said that people are switching plans with ACA, how much of that is they're switching to a lower reimbursement levels and how much is they're just switching to plans where you're not covered and so you don't get reimbursed at all?**

Eric K. Steen: Well it's a combination of both, and sometimes them switching plans makes it difficult for our current system to follow the change you know the information that we need. For example, one payer might have different requirements than another payer, so I'm not sure of all the details.

Jan, do you want to - - do you have any thoughts on that? Do you want to speak to that a bit?

Janet Skonieczny: Sure, Eric, I would be happy to. I actually think it's a combination of both. The one big change that we're seeing is patients are now being enrolled in plans that are high deductible so… Although the allowables and the fee schedules may still be strong, we're dependent on a larger portion of that reimbursement coming from the patient, which as you know can be difficult in a segment where we're talking about oncology patients who have mounds and mounds of other medical bills. So that's the challenging piece of it, and then the other piece obviously would be dealing with new plans with respect to the Affordable Care Act where we hadn't put as much contracting focus and so now we're in the process with Steve's team of gaining additional contracts and making sure that we're in-network with all of these

new Medicaid managed care plans and we're… It's just a process, but we've made a lot of progress and will continue to do so.

Doug Weiss: So, I mean wouldn't you see a spike up at least short-term in bad debt expense because of what you're describing with the higher patient pay?

Jonathan P. Foster: This is John. We did, and we did see that in the first half of this year. As I mentioned in the call, for the third quarter we came down, and that is a result of Jan's group really focusing on patient pay. We've now set up this year a specific group that deals with patients. We have a special process for identifying those that are in need that will provide free care, so it's gotten a little more granular on the side of patient collections that in the past the calls of reimbursement wasn't entirely focused on as it should've been.

Doug Weiss: So I mean I guess bigger picture, how quickly do you think that you'll have the new processes in place and the growth and census will flow through to revenue growth?

Jonathan P. Foster: I think what's very key is in Jan's comments when she's talking about CMS and the range of cuts as we digest what was in the 500-page document that was released Friday after - - I mean Thursday afternoon of last week that we'll be able to fill in those holes, you know some or all. And from our standpoint when you're looking at all the things we're talking about that Eric has mentioned from IT improvements, operational improvements, contract improvements, that we have more on our chalkboard of potential revenue or cost enhancements that are greater than those numbers in the CMS column. But we're talking about by 2016/2017.

Eric K. Steen: But certainly we're going to have additional payer contracts even this year that will help us capture more money from these exchange plans.

Doug Weiss: Right.

Janet Skonieczny: Right, so the focus has been really just - - it's been threefold - on new contracts, on enhancing the terms of existing contracts, and placing - - adding more staff to focus on assisting patients with payment plans to bring their dollars in the door quicker.

Doug Weiss: Right, okay. **And then, yeah, go into the CMS announcement, you said 1 to 2 million hit in 2016 and 2 to 3 million hit in 2017, was that your comment?**

Janet Skonieczny: That was correct, yes.

Doug Weiss: So is that cumulative or is that - - in other words is that a cumulative hit of 3 to 5 million or is that even…

Janet Skonieczny: No.

Doug Weiss:…in the one to two in that 27th number?

Janet Skonieczny: No, the one to two in the first year is because it's going to be phased in, so for the first half of the year we're only going to realize 50 percent of the impact.

Doug Weiss: Yeah, I see. So that's the total - - the three of the total impact?

Janet Skonieczny: Correct.

Eric K. Steen: Correct.

Doug Weiss: Yeah.

Eric K. Steen: Let me just - - let me just also say that these revenue statements are very forward-looking statement. There's a long way to go. They're made in the spirit that more disclosure is better, so I don't know what the number will be. It won't probably be our estimate though, and there's are a lot of things that are going to change in our operation organization before we get there.

Doug Weiss: Yeah. **But I actually you know my sense is that it's a let's take your high ended estimate, 3 million hit on what is presumably a larger revenue base at that point in time is actually a pretty good outcome for you. I mean I think people a year ago were thinking that number could be larger.**

Eric K. Steen: Oh, it's a great outcome for us; and you know I don't want to look silly celebrating a revenue cut, but the estimates were much higher. The marketplace is littered with carcasses of D&E companies out there, and we just had our highest net income ever and we're continuing to gain patients. Our patients love us; our customers love us. For me it's good news; and I know people looking for quarter-to-quarter adjusted EBITDA probably don't think that way, but I always run a business like it's my own and look at it for the long-term, and for the long-term I'm still very bullish on what we're doing.

Doug Weiss: Yeah. Okay. **Can you say what pain is at this point as a percentage of your revenue mix or do you not want to?**

Eric K. Steen: Each time compared to our total revenue, it's a tiny amount you know in the perspective of things, but it's growing; it's growing. We've just got three new accounts I think the last week, so it's going to ramp up. And when it gets to be more significant, I'm going to really measure… I'll be honest with you, I don't know what the pain revenue is right now and I don't care. I care how many doctors, how many surgeons, how many anesthesiologists, how many pharmacists that we're saving big money in their

budget by not buying these non-reimbursable (inaudible). So when we get a big number of accounts, I'll start looking at the revenue and tell you what it is.

Doug Weiss: Okay. **And that tends to be a little lower margin, is that right in the sense that it has a (inaudible)?**

Eric K. Steen: Not necessarily, not necessarily.

Doug Weiss: Okay. So we shouldn't expect a mix impact if that ramps?

Eric K. Steen: Not for the pain program. I think some of these new disposable offerings we have are lower margin. I think when I came to InfuSystem and they were evaluating new product opportunities, what I always heard was: Oh, well it doesn't make the 70 percent margin that we have here. You know you've got to be kidding me. If just look for 70 percent margin deals, you're apertures going to be pretty narrow. And I'm - - that's not my threshold. I want to grow the business. I want to really grow the revenue and get things ramped up here, so we're definitely going to be looking at some things that have margins less than 70 percent as we go forward.

Doug Weiss: Okay. **And then just following up a little more on those - - your comment on quality and the quality metrics, do those improve your payment rates from Medicare and Medicaid? Is there some tangible flow through in terms of reimbursement rates on those?**

Eric K. Steen: I'll let, Jan, my reimbursement expert, answer that one.

Janet Skonieczny: And the answer to that in the short-term is, no, not directly, but what it does is it gives us documentation and data to go back to CMS with to explain the benefits of the program as we encourage them to broaden their level of coverage.

Eric K. Steen: And I think, Jan, wouldn't it also help you get payer contracts when you can come in and show new payers that information?

Janet Skonieczny: Absolutely. it definitely helps us in the commercial market as well, so you know any time we have additional information that we can get in front of the payers with to help their level of understanding on the benefits because the focus in the payer world is definitely to reduce costs and the way they're going to do - - see cost savings is through treating patients in the home.

Doug Weiss: Right. **So in terms of broadening the coverage, that means broadening Medicare and Medicaid payments on the pain side is that correct?**

Janet Skonieczny: Correct.

Doug Weiss: Okay, got it.

Eric K. Steen: You know in broadening, there are also oncology patients that we are currently non-contracted for, so I just want to mention that we're broadening our payer contracts for our oncology patients as well.

Doug Weiss: Okay. **So just in terms of modeling gross margin, and this I guess goes back a little bit to how quickly you're implementing these changes that you've discussed, I mean so you've had a bit of a sequential dip here in gross margin, would that - - do you think that's going to improve sequentially going forward?**

Eric K. Steen: I think on our organic business, it will improve, and I would say we're going to collect more - - we're going to be collecting more money from our expanding payer contracts and we're going to be

doing things more efficiently. So for organic growth, organic growth, I think it will improve. We'll get back where we were before. But I think to more rapidly grow the business, I'm looking to do new things and some of those things that more rapidly complement our business and create an attractive package of offerings for the different segments we're in. Some of those new opportunities may be less than the 70 percent gross margin we currently enjoy.

Jonathan P. Foster: And just to follow along with that, as I had mentioned, the trend has been that sales are increasing faster than rentals and sales has traditionally a lower gross margin and I think the increase in sales will outpace the increase in rentals, so you'll have an (inaudible) issue there.

Doug Weiss: I see. **And then on G&A, you said you had $500,000 roughly in - - you know in investment in new equipment and technology. Is that going to continue next quarter and into 2015 or does that drop right out?**

Jonathan P. Foster: No, the investment in IT and pain will continue. The other unexpected charges on the pump charge-offs and the severance, that shouldn't be repeatable as we move forward. I think we've gotten through the majority of that.

Doug Weiss: How large was that?

Jonathan P. Foster: Pardon.

Doug Weiss: How large were the nonrecurring charges?

Jonathan P. Foster: Roughly a half million dollars…

Doug Weiss: Okay.

Jonathan P. Foster:…year to date.

Doug Weiss: Okay. **And how much were they in this quarter?**

Jonathan P. Foster: Oh, I think roughly two to 300,000.

Doug Weiss: Okay, and the last question. **Just on taxes, so why - - could you just explain a little more clearly why taxes were - - the tax - - the gap rate was so high? Your cash taxes I assume were considerably lower?**

Jonathan P. Foster: But with the expansion of our business over the last few years, we've expanded into states where we don't have an NOLs, so we do have a tax rate there and also we have Canadian taxes. Our Canadian operations are profitable. We have no NOLs there. And so I think you'll see that rate float down. We're… We've already done some Canadian tax planning. We'll continue to do more, so I would look for that rate to go for - - go down as we go into 2016.

Doug Weiss: I mean what's a good normalized tax rate to use?

Jonathan P. Foster: Something less than we have today. I would say looking at it… Hold on one sec. Let me take a look at it. You're looking at, I would say between 40 and 45 and closer to the 40 number as we get going.

Doug Weiss: Now that's your actual cash taxes or that's more of just a (inaudible)?

Jonathan P. Foster: (Inaudible) taxes.

Doug Weiss: Book taxes.

Jonathan P. Foster: No, we have $14.3 million in federal and state NOL carry forward, but that differs by state. If we go into a state that we didn't do business in before or as much business, we didn't have an NOL, then we're paying taxes on it, and that impacts the calculation - - the effective tax rate on our books.

Doug Weiss: Right. **I mean it seems awfully high. I mean are the NOLs actually skewing the tax rate up in some in you know counterintuitive way?**

Jonathan P. Foster: Well that and also the Canadian.

Doug Weiss: Yeah, okay. So I mean… All right, I mean I guess there'll be more time to discuss that as you (inaudible).

Jonathan P. Foster: Yeah. But as I said, we'll trend down from the 45 rate down to the 40 rate.

Doug Weiss: Okay. **Just one last question on where - - on cash flow and seasonality of cash collection and so forth, I mean do you have some targets for where you think you can get debt to over the next year?**

Jonathan P. Foster: That all depends. I mean as we've mentioned before, our priority is first growing our recurring rental revenue base, which involves investing in our rental fleet. So first and foremost where you have a 1.5 times return on an investment in rental, you know rental revenue over the CapEx you're spending, you know we got to take it. That's too much of a low hanging fruit. And then we also have this variable package as we trade in and replace the end of life pumps, that will be a variable that will go up and down that we'll manage, and then after that is paying down debt and reducing our cost of debt. So those were the priorities that as we bring on - - we have a 250 pump account that our sales force brings

to us, we're going to take that 250 pump account, but that just increases our recurrent rental revenue and that's ultimately where the cash flow comes from.

Doug Weiss: Right, okay. All right great. We'll talk to you next quarter.

Jonathan P. Foster: Super, thanks, Doug.

Eric K. Steen: Thanks for your questions.

Operator: *I will now turn the call over to Eric Steen for closing comments.*

Eric Stein: Okay, well want to thank everyone for joining our call today and look forward to seeing you and talking to soon. Bye-bye.

Operator: *Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.*