AdaptHealth Corp.
Third Quarter 2020 Financial Results Conference Call
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<u>Presenters</u>
Chris Joyce, General Counsel
Luke McGee, Chief Executive Officer
Josh Parnes, President
Jason Clemens, Chief Financial Officer

<u>Q&A Participants</u>
Matthew Blackman – Stifel
Stephen Tanal – SVB Leerink
Pito Chickering – Deutsche Bank
Brian Tanquilut – Jefferies
Anton Hie – RBC Capital Markets
Richard Close – Canaccord Genuity

Operator
Hello, and welcome to the AdaptHealth Corp. Third Quarter 2020 Financial Results Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require operator assistance, please press "*" "0" on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to turn the call over to Chris Joyce, General Counsel. Please go ahead.

Chris Joyce
Thank you, Devon. I'd like to welcome everyone to AdaptHealth Corp.'s earnings conference call for the quarter ended September 30, 2020. Everyone should have received a copy of our earnings release earlier this morning. If not, I'd like to highlight that the earnings release, as well as a supplemental slide presentation regarding Q3 2020 results, is posted on our Investor Relations page. In a moment, we'll have some prepared remarks from Luke McGee, Chief Executive Officer; Josh Parnes, President; and Jason Clemens, Chief Financial Officer. We'll then open the call for questions.

Before we start, I'd like to remind everyone that statements included in this conference call and in our earnings release may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act. These statements include, but are not limited to, comments regarding our financial results for 2020 and beyond. Actual results could differ materially from those projected in such forward-looking statements because of a number of risk factors and uncertainties, which are discussed in our annual and quarterly SEC filings.

AdaptHealth Corp. shall have no obligation to update the information provided on this call to reflect such subsequent events. Additionally, on this morning's call, we'll reference certain financial measures, such as EBITDA and adjusted EBITDA, which are non-GAAP financial measures. A table providing supplemental information on EBITDA and adjusted EBITDA is included in today's first(SP) quarter earnings release. This morning's call is being recorded, and a replay of the call will be available later today.

I'm now pleased to introduce our Chief Executive Officer, Luke McGee.

Luke McGee
Thanks, Chris, and thanks to everyone for joining the call. Before I get to my remarks on the third quarter, I would like to acknowledge the tremendous efforts of AdaptHealth's frontline branch staff, clinical teams, and delivery drivers, who've played such an important role in AdaptHealth's continued service of our patients' health needs during these extraordinary times.

Throughout the last eight months, our priorities have been and will continue to be the health and wellbeing of our patients and our workforce. I am incredibly proud of the entire AdaptHealth team and how each and every team member has stepped up to help those in need throughout the COVID-19 crisis.

We ended 2019 as a fast-growing and profitable home medical equipment company with a small medical supplies business. With acquisitions in 2020, we have not only accelerated the growth of our home medical equipment business but importantly have added a large and growing supplies business with a concentration in advanced diabetes supplies and management.

We continue to be active acquirers of traditional HME businesses in the third quarter. When we acquired the HME assets of Advanced Home Care and Healthline Medical in March, we noted that there would be merit to adding additional density in the Southeast and Southwest. To that end, we acquired Family Medical, a $40 million revenue HME in Eastern North Carolina, in mid-August, and closed on another acquisition in Texas in early October. These additions add important scale in high-growth geographies.

We also made several smaller HME acquisitions in the Mid-Atlantic, Midwest, and New England during the quarter. We are excited about the key operational leadership from these acquired companies and have retained many as leaders within AdaptHealth.

In diabetes, we view Solara as a platform on which we can grow our much larger national diabetes distribution and management business. We are excited about the continued market growth and continuous glucose monitors and insulin pumps and believe adoption rates will accelerate. Recently, we closed our first diabetes add-on acquisitions with the purchase of Diabetes Supply Center of the Midlands and Pinnacle Medical Solutions. These acquisitions should add $85 million to $90 million to diabetes revenue in 2021.

Our entry into the diabetes supply management space, along with our incumbency in the sleep disorder space, gives us the ability to generate useful real-time information about the health of our patients, particularly those with chronic conditions. This is the high priority for AdaptHealth as we evolve from a provider of equipment and supplies to a more complete connected healthcare solutions provider.

We have an active M&A pipeline and plan to continue to be selectively inquisitive as we identify opportunities that deliver financial results in accordance with our disciplined approach, while also furthering our strategic goals. Although our pipeline is robust, we are not including future acquisitions in our guidance for the remainder of 2020 or for 2021.

On the regulatory front, we received positive news from CMS last week in regards to the Medicare competitive bid program. As a refresher, the round 2021 competitive bid program was originally scheduled to be effective on January 1, 2021, and encompass 16 bid categories. On Tuesday of last week, CMS announced they would be proceeding with only two product categories - off-the-shelf back and knees braces. Although not entirely clear and subject to change, we interpret this announcement to mean a delay in the competitive bid program for any other categories until at least 2024.

Additionally, in the proposed rule, CMS has indicated that they intend to make the higher blended rates in rural territories permanent, which is a welcome development. We await further guidance from CMS on whether they will be providing inflation increases, performing competitive bid products and territories. In total, we believe these changes to the competitive bid program in rural rates are a positive, and we expect the rate changes for the off-the-shelf back and knee braces to be immaterial to AdaptHealth.

The proposed CMS rule also affirmed Medicare Part B coverage for continuous glucose monitors and expanded the universe of covered CGM devices. Although the vast majority of CGMs that we currently distribute have already been covered under Part B, we view the affirmation as positive.

Now, I'd like to turn the call over to Josh Parnes, our President, to discuss our innovation activities.

Josh Parnes
Thanks, Luke. As Luke mentioned, we are extremely appreciative of the entire AdaptHealth team. We had an extremely busy and successful third quarter with operating our core business, integrating previously announced acquisitions, and closing the new acquisitions mentioned earlier. Additionally, we made significant strides in building our infrastructure and investing in scalability.

On that topic, we are thrilled to welcome Bryan Breen as our new Executive Vice President of Managed Care. Bryan will be focused on helping us expand our relationships with payers and formulating alternative and value-based reimbursement models.

Although we still face ongoing challenges presented by the COVID-19 pandemic, we've made adjustments in our operations protocols to ensure continued business stability and growth. We are seeing our new starts increasing to pre-pandemic levels, as many facilities have welcomed back our operations teams and sales force.

Within those facilities, our health system access protocols are focused on keeping our employees equipped with PPE and compliant with prescreening protocols and social distancing guidelines. To give some context, (INAUDIBLE) hit a low of approximately 30% against pre-COVID levels in mid-Q2. Q3 was up sequentially off approximately 10% to 15% against pre-COVID levels. And the last month of Q3 and the first few weeks of October are off mid-single digits against pre-COVID levels.

Most of our administrative operations remain virtual, leveraging our investments in cloud-based technology across our back-office functions. Shifting to the ongoing integration focus of our acquired businesses, our PCS turnaround efforts continued to produce the financial results that we had expected. Turnaround results don't come easily, but we are applying our expertise in resupply, product formulary, and purchasing, all with solid results.

We are also driving improvements for PCS in revenue cycle and efficiencies in labor and other operating expense. We continue to believe PCS will be profitable in the fourth quarter of 2020. We've transitioned the legacy PCS CGM business to Solara, and we’ve transitioned the legacy PCS incontinence business to ActivStyle, leveraging the core operational capabilities that came with those businesses.

In addition to our integration work, we continue to stay focused on technology and business processes throughout the balance of 2020 and have big plans for 2021. Our text and mobile app-based orders are increasing in ActivStyle and Solara, respectively. Our e-Prescribe penetration remains a top priority, and our e-Prescribing initiatives continue to result in less paper, less faxes, and greater adoption by our referring providers.

Although there is still a long way to go to achieve our goals, there also remains tremendous opportunity to unlock internal labor efficiencies and referring provider satisfaction. With continued investment, we believe we can drive down operational costs while offering a better patient experience for our more than 1.8 million patients that we service annually.

Our technology capabilities are advancing. We recently launched a pilot for CGM e-Prescribing built upon the same backbone that we are utilizing within our HME business, and we believe this will help us increase orders to reduce turnaround times. We also recently completed an assessment and validation of our vision for connected care. We plan to launch a pilot in the first half of 2021 that will provide our patients better visibility to their clinical data, including an electronic resupply capability.

At this point, I'll turn the call over and welcome our new CFO, Jason Clemens.

Jason Clemens

Thanks, Josh. Good morning and thanks for joining our call. I'd like to start by welcoming our new Chief Accounting Officer, Frank Mullen, who joined AdaptHealth in late September. In addition to deep accounting expertise, Frank has years of experience leading various administrative functions in large public companies. He's already proven to be a great partner and contributor.

Turning to our results for the third quarter of 2020. AdaptHealth generated net revenue of $284 million, an increase of 108% from the third quarter of 2019. Adjusted EBITDA was $53 million, an increase of 68% from the third quarter of 2019. Adjusted EBITDA less patient equipment CapEx was $36 million, an increase of 92% from the third quarter of 2019.

These financial results do not include the recognition of funds received in April as part of the CARES Act Provider Relief Fund. Our company is in the process of evaluating the updated post-payment notice of reporting requirements published by HHS in late October. We expect some benefit based on the latest requirements, and we will report any benefit as soon as we finish our evaluation, possibly by the end of 2020.

Our third-quarter financial results are even more gratifying in the face of the slowdown in elective medical treatment as a result of the pandemic. As elective procedures have come back, so has revenue across our products that are primarily indexed to electives and emergency room discharges. As Josh mentioned, new sleep starts were down 30% in the second quarter, but by the end of the third quarter, sleep starts rebounded to above 90% of pre-COVID levels.

The improvement is driven primarily by our operational changes that Josh spoke about earlier, as well as growing reopenings of sleep centers. We continue to believe that as our volumes revert to normal levels, we will grow organically at high-single digits, just as we did in Q1 2020 before the disruption caused by the pandemic.

Our third-quarter cash flow from operations was strong and remains the primary focus for our management team. As our diabetes and supplies products continue to grow, patient equipment CapEx becomes less intensive. So, in addition to adjusted EBITDA less patient equipment CapEx, we are keeping a close eye on how much cash converts from adjusted EBITDA.

On a reported basis, operating cash flow for the nine months ended September 30, 2020, was $145 million. That includes approximately 46 million of CMS advanced payments and $17 million in CARES Act Provider Relief Funds. Adjusted EBITDA for the same period was $126 million.

Excluding the CMS advanced payments and the CARES Act Provider Relief Funds, operating cash flow was $82 million or about two-thirds as a percent of adjusted EBITDA for the same period. In regard to our balance sheet, we ended the quarter with $272 million of cash, and we had zero drawn on the revolver under our credit facility.

Now, I'd like to turn to our guidance for the fourth quarter and our preliminary outlook for 2021. Neither the 2020 guide nor the 2021 preliminary outlook include recognition of the funds from the CARES Act Provider Relief Funds. As announced this morning, we are increasing our 2020 full-year guidance for net revenue, adjusted EBITDA, and adjusted EBITDA less patient equipment CapEx.

Our previous 2020 full-year guidance for net revenue and adjusted EBITDA less patient equipment CapEx was $935 million to $983 million and $120 million to $127 million, respectively, which included ramping contributions from our July 1 acquisitions, but did not include contribution from additional M&A following Solara and ActivStyle.

Luke mentioned a number of key acquisitions that we made in the quarter as well as Pinnacle on October 1. We expect these acquisitions to be immediately accretive to earnings, and we are therefore raising 2020 full-year guidance for net revenue to $1.00 billion to $1.04 billion, adjusted EBITDA to $186 million to $194 million, and adjusted EBITDA less patient equipment CapEx to $124 million to $130 million.

Turning to 2021. We cannot perfectly predict the ongoing impacts of COVID-19, but we continue to believe that our organic growth will return to normalized levels by the first half of 2021. There are a few other key assumptions driving our guide, including end-market growth, particularly for diabetes; our ability to grow share across our product lines; and financial returns on key investments we're making in technology as well as efficiency projects aimed at our direct and indirect costs.

Although our M&A pipeline is healthy, we are not including contribution from future acquisitions in our guidance. We believe that the core business will grow at 7% to 10% organically. Solara and ActivStyle businesses acquired on July 1 will deliver previously announced full-year proforma targets, and additional businesses acquired between July and October 2020 will hit their full ramp by the second half of the year.

We are guiding to net revenue of $1.30 billion to $1.40 billion, adjusted EBITDA of $260 million to $280 million, and adjusted EBITDA less patient equipment CapEx of $180 million to $200 million.

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

Luke McGee
Thanks, Jason. In conclusion, I'd like to reiterate my thanks and appreciation for all of our AdaptHealth employees that have stepped up and delivered record financial results while continuing to serve our patients and referral partners with courage and professionalism. I remain more confident than ever about our strategy and prospects.

Operator, please open the line for questions.

Operator
Certainly. We will now be conducting a question-and-answer session. If you would like to be placed in the question queue, please press "*" "1" on your telephone keypad. A confirmation

tone will indicate your line is in the question queue. You may press "*" "2" if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing "*" "1". One moment please, while we poll for questions.

Our first question today is coming from Mathew Blackman from Stifel. Your line is now live.

Mathew Blackman
Good morning, everyone. Can you hear me, okay?

Luke McGee
Yes. Hi, Matt. How are you doing?

Mathew Blackman
I'm doing well, Luke. Thanks for asking. Maybe to start, there are always a lot of moving parts in the business, and as we think about the new 2020 guide, is there a way to maybe just help us bridge a little bit how much of that raise, and maybe put into three buckets, how much of the raise roughly are the deals you acquired in the third quarter plus Pinnacle versus performance of recent deals like Solara or ActivStyle? And then I guess any sort of puts and takes in the organic business, is it possible to maybe give us some color across those different drivers?

Luke McGee
So, Matt, I think it's going to be difficult to break into those two buckets, but I can certainly give you some context. I think our core business is performing slightly above plan that we established at the beginning of the year. We're very comfortable even despite COVID, the strength of the resupply business, the way that it started to bounce back that Q4 should be largely in line with where we started the year. ActivStyle and Solara are running quite well. We're sort of in the middle of integration activities. And given that we're only sort of second quarter in, like there's not a material kind of beat versus expectation yet, although I will note that we're very excited about trends in both of those businesses. And so most of the guide increase is related to the acquisition activity, both completed in Q3, and then the Pinnacle deal, which closed on October 1.

Mathew Blackman
Okay, that's really helpful. And then maybe, Jason, do you have handy what you guys think the organic growth number was in the quarter? And then I just have one follow up.

Jason Clemens
The organic growth for the third quarter was a little over a point. So, again, in the face of COVID, I mean, we're actually pretty pleased with those results. As you heard in our prepared remarks, starts, particularly around sleep, are coming back. As you know, there's a bit of a compounding effect on that. So as Q2 hit in the midst of COVID, and starts were down materially, there is a compounding effect of that, that we're in the middle of that we're starting to see pull through going in a positive direction.

Mathew Blackman
That makes sense. And then just two quickies on diabetes, and maybe we modeled it a little too aggressively, but Solara looked just a little bit light relative to, I'm talking very little light versus what we're expecting. Just curious how that quarter shaked out versus your expectations? And then, as we think about some of the deals you completed in the quarter, is there any sort of common theme or thread? Is it just increasing patient scale? Is it broader geographic exposure? I suspect it's not really portfolio expansion and probably some combination of all the above, but just any color on that would be helpful too? Thanks so much.

Luke McGee
Yes. So on Solara, revenue was a little bit weaker than we had modeled, but that's really just due to the full follow-on impact of the TRICARE rate cut that was known to us in the beginning of the year, and we were just a little aggressive in the way we modeled it. I will tell you that the new start trends are well ahead of budget in terms of new patients getting set up and also the patients being resupplied. And so from a growth perspective, if you asked me today versus when we announced Q2 results versus when we closed the deal, I think we're very pleasantly surprised by the underlying organic unit growth in diabetes. And once we sort of – we basically have fully absorbed that TRICARE rate cut and understanding what it means, we're very excited about the outlook for our diabetes business across the board; at Solara, at DSCM, at Pinnacle, the market, we believe we are taking share, but the market is growing quite rapidly, as many of you guys know, just with the increasing prevalence of CGM.

On the acquisition side, I think it was a mix of, you know obviously when we acquired Solara, we said we viewed it as a platform, and now we've done two acquisitions. And I would expect that over the next year, we'll continue to do more to add both geographic density and exposure. Pinnacle, absolute strong player in the Southeast, high diabetes prevalence in those states and so that was an attractive sort of piece of business for us. Very good management teams, very good systems. We are fortunate that both DSCM and Pinnacle run the same billing software we do.

On the HME side, when we did the deals earlier this year in March, we did say that we'd like to kind of do more than one deal to really establish ourselves in geography. And so we were able to do that in the third quarter and early October in Texas and the Southeast. And then there were some small tuck-ins. We did a deal in Western Pennsylvania that gives us more density there. We already had existing operations with a small deal to expand our footprint and give us additional growth opportunities up in New England and did a very, very small deal in the Midwest. We continue to see a nice pipeline of acquisition activity. And so it will likely at this point be some slight geographic expansion. New England in the upper Midwest is still under-penetrated for us. And then on the diabetes side, we'll obviously continue to add scale there.

Mathew Blackman
All right. Thank you. Very helpful, and congrats again on a great quarter.

Luke McGee

Thanks, Matt.

Operator
Thank you. The next question is coming from Stephen Tanal from SVB Leerink. Your line is now live.

Stephen Tanal
Good morning, guys. Thanks for the question. I guess I'd asked you about competitive bidding and how much you're reading into what happened there. So the fact that CMS pulled out 13 to 15 product categories, all the ones that had been through the program in the past, at least one round, and the reason they cited, right, that they didn't get effective savings from the bids. Like I don't know how much to read into that, I'd love to hear how you guys are thinking about that and what that may or may not mean for the future of this program?

Luke McGee
Yes. It's always dangerous to try to read too much into what was just a press release from CMS. But if we back up, as we told most of our investors and the analysts, we did expect that there wouldn't be savings. There would actually be increases in a number of categories, given how far rates have come down in certain categories and given how non-competitive certain markets are. So I'd say it's not a huge surprise.

And if you want to be a complete optimist, you'd say that not getting savings in a competitive bid program, it may not be 2024, it actually may be a permanent sort of delay or cancellation of bidding in these categories, because they didn't get the savings they want. At the same time, who knows? I will say it doesn't feel like trying to eke out the savings from the existing bid category should be a high priority of CMS now. I think that the market has told CMS that they have found the bottom and maybe even found below the bottom on rates. And so we're excited about having rate stability for the next three years, certainly gives us visibility and confidence in executing our plans.

Stephen Tanal
Absolutely. And I guess I talked to folks in DC to figure out kind of what led to that, I heard a lot about sort of the structure of bidding and ultimately going with the clearing prices, potentially the big issue for the guys who had kind of gone through all the bids. So, do you read anything into this reflecting on like the structure of the market? I think there's a train of thought that goes, well, this is the outcome, perhaps the industry at this point is stable and maybe consolidating and no longer looking to sort of outdo itself on bids, or maybe it really just is the changes to the structure of the competitive bidding programs. I don't know if you had any specific comments there, but I'd be curious to hear your thoughts?

Luke McGee
We welcome the changes because our clearing price actually does reflect market supply and demand. And so we do think that moving from what was sort of a noneconomic median bid process that the industry and noted economists had sort of challenged in 2013 and 2016 when

they did it. The move to clearing prices and move to market-based economics and now the market has spoken and said that the rates were--if you want to read between the lines are too low as they exist. We do believe that the market will continue to consolidate. And so, again, we welcome the delay or cancellation.

Obviously, in a perfect world, we could have seen higher rates. But we understand that also the healthcare costs need to go down, and we are working very, very hard to make sure that we can be the low-cost provider ourselves, and we can also enable lower-cost healthcare in the home.

Stephen Tanal
That's great. If I can just sneak in one last one and then I'll yield. Just the 1% organic growth rate that Jason gave out there, how did that compare to your expectations? What were you guys looking for in Q3 with all that is going on in the backdrop?

Luke McGee
I think we're pretty happy with--you know in the quarter at 1% is still positive year-to-date in light of COVID. We knew Q3 and frankly the early part of Q4 the hardest hit from the compounding of past(SP) rental revenues. And so to be able to deliver that, yes, I'm incredibly proud of the team. I think we're setting up for a higher number in Q4, and as we go into 2021, back to our previously forecast range.

Stephen Tanal
Really helpful color. Thanks a lot.

Operator
Thank you. The next question today is coming from Pito Chickering from Deutsche Bank. Your line is now live.

Pito Chickering
Good morning, guys. Thanks for taking my questions. To follow up on Matt's question on revenues, in the script, you talked about core ops growing organically 7% to 10%. There's obviously been a lot of moving pieces in 2020 due to COVID. When you think about organic growth in terms of both rental and sales, should we base it off of 2019 due to the tough comps in 2020, so 7% to 10% each segment for 2019 baseline, or is there a better way of thinking about it? And also, with the recent Pinnacle deal, how should we think about organic growth in diabetes for 2021? What percent of revenues in 2021 will come from diabetes?

Luke McGee
So on the first one, it's a good question. Obviously, we've been so acquisitive with 19--2019 as the hard baseline. Obviously, we do expect to see growth and core growth in 2020, despite COVID. Obviously, if you look year-to-date, I think we're sort of in the low to mid-single digits, certainly higher than 1%, and that excludes B2B. And so, we can follow-up with you offline

about how to model it, but I don't think that starting in 2019 is going to be the easiest exercise, just given how acquisitive we've been.

On the second piece, diabetes is a fast-growing market. And so we would expect our diabetes business, and there's some blend to get to 7 to 10 of above-market diabetes growth, diabetes should be a mid-teens grower for us in 2021. I think that's probably somewhat conservative. And if you look at percentage of revenue, you're going to get to mid-20s, as we continue to grow that, and that is just with what we own today. Again, we like the acquisition landscape in diabetes. We think that there's a similar playbook to execute there that we've done in core HME. And so with those, it could even skew higher.

Pito Chickering
Okay. And then a question on the margins. There's a lot of moving pieces obviously on 2021 margins with all the deals you guys have been signing. On the surface, it looks like fourth-quarter margins are guided to be 13.7 at the midpoint. 2021 margins guided to be 14.1% at the midpoint. Can you walk us through the moving pieces of the margins for 2021? Where are you getting leverage, the impact of acquisitions, and any areas of pressure that we should be thinking about?

Jason Clemens
Hi, Pito. This is Jason. Thanks for the question. To your point, a fair amount of this movement is just profile. And so this base business is changing materially with the add-on in diabetes and what we're seeing is very strong growth in diabetes. So you are seeing some of that pull through and just the change in the market profile and the increase that you mentioned. Additionally, as we're continuing to make investments, Josh talked about a number of these areas in his prepared comments. There are plans of cost out in a couple of parts of the business that we're very confident in that's also additive to the profile changes.

Pito Chickering
Okay. And then two more quickies. For the M&A pipeline, you mentioned that it was robust. Have multiples changed today versus what you're seeing pre-COVID?

Luke McGee
Yes, I'd say our--I don't know if it's COVID, I would say our success, I mean we are a victim of our own success in that there are other people sort of watching what we're doing. So, all things equal, HME deals are marginally more expensive. You're talking about a half turn or a churn. And then diabetes, just given the growth profile, we've sort of said historically, the HME deals we think we can buy at 4x to 6x sort of our first year's cash flow, and I still think we can be at the top end of that range comfortably and get sort of significant deals done.

On the diabetes side, I think we said when we did Solara that the deals would be slightly more expensive in diabetes, given the growth. But if you look at like on a year two basis, they're very comparable, and I think we stand behind that. Larger deals will be slightly more expensive on a multiple basis; smaller deals will be slightly less expensive, HME will be slightly less expensive compared to diabetes. All in all, still a very, very accretive financial environment to be an acquirer, but also what we find in these acquisitions, we're adding talent, we're adding business processes. Oftentimes we find, and we found it now in diabetes as well as HME, these smaller, decently sized companies we acquire, they may have a business process doing one part of our complex business better than Adapt. And then we can scale that and bring that across our entire sort of business, you know there is some hidden benefit to these acquisitions.

Pito Chickering
All right. And then last super quick one for Josh just to sort of pull him in here. What percent of all your sales (INAUDIBLE) patients go through e-Prescribing today, and where do you think that goes in 2021? Thanks so much, guys. Nice quarter.

Josh Parnes
So, currently, we're running about 30% of orders coming through or through e-Prescription. And that obviously exclude the resupply, which we have our own technology, that's kind of driving the resupply process. So, the real friction point with the provider is on that new order. So, really, we have a lot of initiatives going on in Q4 and for 2021 to drive that number north of 50%. And we're particularly excited about kind of what we're doing on the CGM diabetes business with e-Prescribing. I've mentioned that in my comments that that's an area that I think is behind even HME as an industry in terms of adoption of e-Prescription and kind of automation. So we're putting a lot of effort into that as well. And we feel like cycle times, automation and improvement and kind of both customer and referring provider experience will help us also drive additional organic growth there on the diabetes line.

Pito Chickering
Great. Thanks so much, guys.

Operator
Thanks. The next question today is coming from Brian Tanquilut from Jefferies. Your line is now live.

Brian Tanquilut
Hi. Good morning. Congrats to the whole team for a good quarter. I guess, Luke, I'll just ask on the M&A front. With competitive bidding kind of behind us now, that seems like, right, does that get you guys more aggressive, or do you think that because it's easier to model and maybe the actual purchase price could be higher that we can see more interest from the sellers?

Luke McGee
It's hard. So we have a really good pipeline that obviously we were working on prior to competitive bidding. I think we were relatively confident that there wasn't going to be a dramatic result, whether it be on smaller providers or ourselves, and we had done a lot of math, and we had shared kind of our perspective that it wasn't going to be a material impact to us. I do think that there were a lot of people just waiting. In a weird way, I don't know what they were necessarily waiting for, which is I think that they just wanted to know what it was

before they decided whether to sell or not. And we continue to see the inbound inquiry on a one-off basis. We continue to see kind of the HME broker community reach out to us. So we do think it will be an active 2021 year on the M&A front.

Brian Tanquilut
Got you. And then just shifting to the diabetes side of the business, are you guys seeing any incremental movement or discussions on the medical benefit versus the PBM benefit and as you do some of these acquisitions, I mean, how are you thinking about the M&A strategy there if we're starting to see some more shifting to pharmacy?

Luke McGee
Obviously, our manufacturer partners on the diabetes side, whether it be on insulin pumps or CGMs, have voiced their desire to see more of the business go through a pharmacy benefit. We continue to believe that there is a piece of the business for both those products that will always be under a medical benefit, particularly Medicare affirming Part B coverage. I think we saw one payer in the quarter move to a pharmacy benefit across our entire business. And so, is it a gradual move that's happening? Yes. Is it a land shift? No.

As a reminder, we have pharmacies. Both DSCM and Pinnacle have the capability to do sort of pharmacy business. There are positives and negatives. It's generally lower gross margin business and slightly lower contribution margin business. At the same time, the RCM function in claims adjudication in a pharmacy is much cleaner, much faster. And our ability to cross-sell to patients I think will subsume any pharmacy benefit movement, which is if we can, either a medical or (INAUDIBLE) benefit, we can be providing the insulin pump, whether it be the Medtronic and Tandem along with the CGM. To me, there's more upside in that. And then the other thing I'd just like to point out about the diabetes business is, not only are we seeing kind of very robust sort of market growth in terms of new patients being set up on these therapeutics but really, as a reminder, Medicare only started covering CGM in 2017.

And so in a census-based business where a patient gets set up and then should be on the therapy for a long length of time, we're relatively early in the census compounding where new starts so outweigh attrition, that we have a lot of tail winds (INAUDIBLE) diabetes. And we have yet to unlock, although we're starting next year on a pilot of how we really kind of try to measure and manage sort of chronic comorbid patients across diabetes, sleep, and other diseases. And so there's lots of tailwinds. Is pharmacy a slight headwind? Undeniably.

Brian Tanquilut
Yes, that makes sense. And then I guess for Jason, just a quick question on patient CapEx. As a percentage of revenue from rentals, is this a good number to be using going forward, the Q3 number?

Jason Clemens
Yes, I think it's a fair way to look at it in terms of a percent of rental revenue. If you look at our history, we've kind of bounced around between, call it, 17% and maybe 24%, 25%. As a percent

of rental revenue for the quarter, it was 22 points and year-over-year it was like 24 last year. So I think it's a fine way to think about modeling.

Luke McGee
I think the number is largely correct. We did as far as snapback (INAUDIBLE) a bunch of patient CapEx, maybe a touch high in Q3 just given that we did purchase quite a bit of app equipment to meet the growing demand.

Brian Tanquilut
Got it. Okay. Awesome. Thank you, guys. Congrats again.

Operator
Thank you. Our next question today is coming from Anton Hie from RBC Capital Markets. Your line is now live.

Anton Hie
Yes. Good morning, guys. Thanks for taking the question. Just a couple of follow-ups on some of--picking up some of the threads from the previous questions. But looking back at kind of competitive bidding, can you talk about how that may have impacted sort of your purchasing power overall and relationships with some of the suppliers?

Luke McGee
Yes. So I think that because it was a big unknown, we had sort of delayed or mutually agreed that until we had better stability on rates that it wasn't a productive environment to talk about go-forward pricing with our manufacturer partners. Certainly, our perspective is, as we aggregate scale, there are a variety of reasons why scale shouldn't mean lower purchase costs. Obviously, I'm not sure our manufacturer partners completely agree or want to agree with that approach. But we feel quite strongly about that. So now that we have rate stability, I think you'll see us over the next few months and maybe into Q1 sort of going back and establishing sort of 2021 and 2022 purchasing targets and relationships with our manufacturers.

Anton Hie
Okay, great. And then I'm glad to hear new PAP(SP) starts are cranking back up. Can you remind us kind of what the sort of tail revenue from that looks like on the supply side?

Luke McGee
Can you say that again? I want to make sure I followed that.

Anton Hie
Just trying to get an idea for the sort of the timing on when you could really see the benefits on the supply side from new starts in CPAP?

Luke McGee
We get the new supply order when you set it up. But I'd say to get the full benefit, it's probably six months. And so really as you come into the second half of Q1 and Q2 of next year, that's

when our rental revenue should have recovered based on the declines as well as you should see some snapping back of the supply. I think the unknown and the optimists would tell me that COVID has elongated patient stay on therapy in patients that would have otherwise fallen off PAP therapies are now more committed, and so we've reduced the attrition curve, you know, because that comes and we're right, and we can keep those patients on coming into Q1, Q2, yes, we're going to see a nice benefit on supply business as starts come back.

Anton Hie
Okay. And then one more follow up that kind of tails off that. It seems like you guys were getting better sell-through or better contact with patients just as many were hunkered down through the height of the pandemic. Are you still seeing that? Is that still sort of a durable driver in the business as more people return to work?

Luke McGee
Yes, I think we certainly saw the big spike at the end of Q1 and early Q2, and we've been able to maintain that. It's not continuing to accelerate. I think our resupply team that’s led by a gentleman named Matt Cox, he's just doing an amazing job. And so, we've been able to keep up the momentum that we gained. It's not accelerating, but, again, I think that some of that's due to the lack of attrition in census.

Anton Hie
Great. Thanks a lot.

Operator
Thank you. Our next question is coming from Richard Close from Canaccord Genuity. Your line is now live.

Richard Close
Great. Thanks. Congratulations on the quarter. A lot has been covered here, but Luke, I was wondering if you could just go into the connected health. You mentioned a pilot. Can you give any more details on that timing, what exactly that is, maybe a little bit more there to start?

Luke McGee
So it's sort of multifaceted coming into Q1 and Q2. And I want to be clear I don't expect it to, and we are not, in our guidance, including any contribution from connected health in 2021. I think we're trying to be very cautious to make sure that, although it is such a buzzword that we can actually deliver value to our payer partners and to our patients rather than just sort of chase revenue that is undeniably there to go get, I'm not sure you can get it profitably. I'm not sure you can deliver results, or we can deliver results right now. But we view it in sort of two forms.

The first is getting our patients to engage with technology apps that we can get more data from them, whether it be on scale, blood pressure cuffs, off their CGM device, off their PAP device. And so we were running some pilots in that in Q1. We have a white label partner that we're working with on the app side, and I'm excited about that. And then probably more exciting for us is how we then sort of take some of those readings and learnings and go to payers, and whether we get paid on a PMPM basis, which seems to be kind of the model du jour that's out there, or we go to a payer and say, hey, listen, either we can share in your risk, or we can do this in exchange for more volume. And frankly, I'm probably more bullish on either of those models, and just sort of trying to articulate a connected health PMPM where it's pretty hard to triangulate who's driving the savings for the payer.

Richard Close
And will you be using a third party or entity to evaluate the savings or just any thoughts on that?

Luke McGee
Yes. Our preference is going to be the partner in white label right now. If we got conviction, could we eventually take that in-house or purchase something? Yes. But right now, we'll be working with third parties.

Richard Close
Okay. And then just maybe on the guidance for the remainder of 2020 and then 2020, what do you think the biggest risks are for you guys achieving the expectations that you laid out? Obviously, competitive biddings somewhat in the rearview mirror here, but just any thoughts on potential risk out there.

Luke McGee
Yes. So for 2020, this is a pretty predictable business. I'd say we have high confidence sort of in our guide and the stability and consistency of the business, which hopefully investors are getting comfortable with that we do have great visibility. This is a census compounding business on rental. It's a resupply business that relies on supplying goods to customers. You know we start the month and the quarter with the hopper pretty well full. I think if you look into 2021, I think the great unknown is COVID. What does the next three months look like? I can't tell you I'm terribly optimistic. I think that we could be in for a pretty rough patch here over the next 90 to 120 days. I don't think it's the same as Q1 and early Q2 when it was almost apocalyptic in places like New York. I think the country is generally dealing with healthcare systems and learning to deal with COVID. But that's probably the biggest unknown in hitting the targets that we put out there.

Richard Close
Okay. And then my final question, I guess on M&A, obviously, we're still waiting for results from the election here, but any thoughts on whether it goes either way in terms of how that potentially impacts closing acquisitions as we head into the year-end?

Luke McGee
Yes. Certainly, we've had conversations with sellers, and I think that there was a point of view if there had been a blue wave I think that there would have been people trying to push.

Realistically, we're talking about being 55 days out from the end of the year. Pretty hard to if you're not already in active dialogue and effectively under LOI, it would be pretty hard to close something. But it probably depends on exactly what happens with the Senate. But I guess it's just a way to say I don't think it's going to change very much. The stuff we already have in the pipeline, if you're close enough, I think people probably will prefer to try to crystallize a gain in 2020 and just give the unknown in 2021.

Richard Close
Okay. Thank you.

Operator
Thank you. The next question is a follow up from Stephen Tanal from SVB Leerink. Your line is now live.

Stephen Tanal
Thanks again, guys. Just a really quick last one, I guess I forgot to ask, and just to confirm, what you did was competitive bidding in the '21 guidance. I think we're using like a high-single-digit million headwind. Is that what came back? That's all I have. Thanks.

Luke McGee
For the guidance, obviously, we announced our guide for '21 this morning, so we do know the competitive bid. And so we have previously said that we thought it was a mid-teens revenue headwind and sort of a high-single-digit sort of net headwind, so those have come out of our 2021 forecast.

Stephen Tanal
That's all I needed. Thanks a lot, guys.

Operator
Thank you. We've reached the end of our question-and-answer session. I'd like to turn the floor back over to management for any further or closing comments.

Luke McGee
I just want to reiterate our--management sincere appreciation for the hard work of all our employees that helped deliver the results for the quarter. And we look forward to delivering a great Q4 as well. Thank you.

Operator
Thank you. That does conclude today's teleconference. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.