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Inogen, Inc. (INGN)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings. Welcome to the Inogen 2022 Fourth Quarter Financial Results. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] Please note this conference is being recorded.

I will now turn the conference over to your host, Agnes Lee. You may begin.

Agnes Lee
Senior Vice President-Investor Relations & Strategic Planning, Inogen, Inc.

Thank you, Charlie. Thank you for participating in today's call. Joining me are CEO, Nabil Shabshab; and CFO, Kristin Caltrider. Earlier today, Inogen released financial results for the fourth quarter of 2022. This earnings release is currently available in the Investor Relations section of the company's website, along with the supplemental financial package.

As a reminder, the information presented today will include forward-looking statements, including without limitation statements about our growth prospects and strategy for 2023 and beyond; expectations related to our financial results for 2023; expectations related to a return to profitability in 2023; expectations regarding increasing productivity of our internal and external sales teams; progress on our strategic initiatives, including innovation; our expectations regarding the market for our products and our business and supply and demand for our products in both the short term and long term.

Forward-looking statements in this call are based on information currently available to us as of today's date, February 23, 2023. These forward-looking statements are only predictions and involve risks and uncertainties that are set forth in more detail in our most recent periodic reports filed with the Securities and Exchange Commission. Actual results may vary and we may disclaim any obligations to update these forward-looking statements except as may be required by law. We have posted historical financial statements and our investor presentation in the Investor Relations section of the company's website. Please refer to these files for more detailed information.

During the call, we will also present certain financial information on a non-GAAP basis. Management believes that non-GAAP financial measures taken in conjunction with US GAAP measures provide useful information for both management and investors by excluding certain non-cash items and other expenses that are not indicative of Inogen's core operating results.

Management uses non-GAAP measures internally to understand, manage, and evaluate our business and make operating decisions. Reconciliations between US GAAP and non-GAAP results are presented in the tables within our earnings release.

With that, I will turn the call over to Inogen's President and CEO, Nabil Shabshab. Nabil?

Nabil Shabshab

President, Chief Executive Officer & Director, Inogen, Inc.

Thanks, Agnes. Good afternoon and thank you for joining our fourth quarter 2022 conference call. 2022 has been a testimony of the team's ambidextrous leadership, as evidenced by our ability to progress the needed transformation while delivering revenue growth, despite the multiple challenges, including macroeconomic and inflationary headwinds that presented themselves during the back half of 2022. In addition to building a healthy innovation pipeline, we continue to evolve capabilities, processes and systems that can deliver durable and profitable growth in the medium to long term.

I would like to first start by addressing our performance in the quarter. Although we have grown revenue and overcame multiple challenges, we fell short with regards to scaling the needed changes in DTC within the timeline that we originally anticipated. Naturally, this had an impact on revenue mix as well as on gross margin. As we look ahead to 2023, we are confident that our continued progress around commercial excellence and closely managing operating expenses will contribute to our goal to drive adjusted EBITDA improvement in 2023 in an environment where we are seeing moderated revenue growth.

Before I walk through our strategy, I would like to provide some context about our commercial transformation, progress on our innovation and an update on the supply situation. A key element of strengthening Inogen's performance in the short to medium term is driving commercial excellence. In that respect, our efforts over the past 21 months relating to several commercial pilots have informed changes and our go-to-market strategy within and across channels. We have made excellent progress in strengthening our prescriber channel, go-to-market capabilities and delivering solid growth of 23% in 2022 after understanding up and scaling the prescriber team in mid-Q1 2022.

We believe that we can continue to drive growth and productivity in the prescriber channel allowing us to serve more prescribers and their patients in need of our best-in-class POCs. We have also demonstrated the potential to drive productivity within our direct-to-consumer channel, whilst the evolution has been slower than expected. We have continued to apply the learnings from the pilot as we set up for scale to deliver a stronger second half of the year in DTC. The process of piloting and beginning to institutionalize the envisioned improvements in DTC had an impact on our fourth quarter sales and we expect continued impact in the first half of the year with improvements in the second half of 2023.

We have announced an investor event on Monday, February 27, to allow for more engagement with investors and to share productivity metrics, our evolving channel strategy, and the progress on the overarching growth strategy.

This year, we plan to drive further differentiation for Inogen in COPD with anticipated new product launches in 2023 in the US and Europe after securing the necessary regulatory clearances.

Our focus on innovation-led growth extends beyond the 2023 launches, and we look forward to sharing more detail during our strategy overview on February 27, including how we plan to expand addressable patient population, add indications and extend Inogen's impact beyond oxygen therapy and COPD.

Finally, in 2022, we were successful in our efforts to effectively manage the supply chain challenges. We expect the supply situation to gradually get better in 2023 and we have good visibility for the first half of the year due to the combined effort of securing additional forward buys in Q4 2022 and improvements in the regular supply channel for semiconductors.

Open channel purchases of semiconductors remain part of our efforts to ensure supply continuity, and as such, during 2022, we continue to forward buy semiconductors with the premium paid with impact product cost until we sell through all of the parts acquired at higher prices. This strategic decision has helped us ensure supply continuity through the first half of 2023, improve visibility into Q3, and is a strategy that we will continue to use selectively if and when required. As a result of improving supply visibility and the progress that we have made with our commercial evolution, we will be issuing annual guidance for 2023 and Kristin will go into more detail later on in the call.

I would now like to move to an update on our growth strategy. As our strategy evolves, core tenets remain constant as it relates to balancing investment choices to diversify our portfolio, deliver scalable growth, and allow for a return to profitability in the medium to long term. We continue to characterize our growth strategy in terms of short to medium term and medium- to long-term horizon with multiple growth vectors for each. The short to medium growth strategy focuses on two vectors. The first is to drive POC-based oxygen therapy by primarily using the strong portfolio in place while improving productivity and efficiency of our commercial operations.

The second vector relates to driving differentiation and growth through new product introductions that will expand the portfolio choices for current COPD patients, serve more advanced COPD patients, and start to expand the indications we address. While remaining focused on the short- to medium-term commercial and pricing excellence in existing channels and portfolio has been a key focus over the past several years where we have made good progress. The major focus was serving patients downstream through our DTC team [ph] for its focus (00:08:57) on cash sales predominantly.

At the beginning of 2022, we subsequently evolved our strategy and directed our investments to stand up [indiscernible] (00:09:07) channel that enables us to serve patients upstream at the point of diagnosis and prescription. This model is analogous with the patient diagnosis, prescription and buying journey and maximizes the opportunity of placing COPD patients on the most appropriate oxygen therapy modality throughout their disease management journey. This patient centric model, which is agnostic to channel boundaries, should accelerate patient and prescriber adoption of Inogen's POC-based therapy, driving scale, predictability and profitability over time.

The progress in the prescriber channel where we saw 23% year-over-year growth during 2022 is core to this new model. Our patient-centric model also lends itself to advancing Inogen's partnership with HMEs in the US and distributors internationally. Our vision of patients and prescribers having access to the most appropriate oxygen therapy modality across channel and service providers offers an opportunity for partners to drive growth while better serving patients and prescribers due to patients predominantly favoring POC-based oxygen therapy according to our primary research.

Additionally, we strongly believe that a more balanced operating model of delivery and non-delivery will also serve as an opportunity to improve the overall economics of an HME or distributor and improve their profitability over time. As part of refining our overall channel strategy, DTC remains the critical driver of our success as we improve productivity and efficiency, and that channel based on the pilots we ran in Q3 and Q4. We continue to believe that all of these channels, whether DTC, prescriber or B2B, have a place in our business model, and we are moving to the next steps to optimize our commercial strategy so that we are well positioned for both growth and profitability.

New product introductions also have a role in driving differentiation and growth in both the short to medium and medium- to long-term horizons. Staying with the short- to medium-time horizon, in December 2022, we started selling Rove 6 in European markets that grandfathered reimbursements upon the receipt of the EU MDR certificate, while fulfilling orders for G5 and other markets that required reimbursement renewal for the newly introduced POCs.

At that time, we also initiated the sequential process of securing reimbursement for Rove 6 in two European countries that do not transfer the reimbursement. We are pleased to share that we have successfully secured reimbursement in Germany, ahead of our expected timeline, and our team has resumed its effort to commercialize the new Rove 6 device in that market through our distributed partners. A review of our reimbursements filed in France is progressing and we will keep you updated with respect to the anticipated completion date of late Q2 2023. Additionally, in December 2022, Inogen received FDA clearance for the Rove 4, and we anticipate the US launch to be in the back half of 2023. We are excited about these launches as an important and imminent next step as we continue to lead in POC innovation.

Shifting now to the medium- to long-term growth strategy. I would like to quickly cover the two vectors involved at the high level on this call while allowing for a more thorough discussion at the investor event on February 27. The first vector relates the continuous efforts around market development for POC-based oxygen therapy, predominantly through clinical evidence and collaboration with our scientific advisory board and key opinion leaders. We are making good progress on our clinical strategy and anticipate sharing some of the results through scientific conferences and publications during the second half of 2023.

The second vector relates to innovations that expand the indications and patient populations we serve. We are making encouraging progress and will be sharing the overall innovation roadmap that strengthens our COPD-focused portfolio and allows us to additionally serve patients with congestive heart failure, dyspnea and potentially hypercapnia in the medium to long term. We will be discussing this in a bit more detail during our investor event next week.

Lastly, as we advance our innovation strategy to serve patients beyond COPD, we remain open to potential acquisitive growth opportunities that would support our aspiration for Inogen becoming a more comprehensive respiratory care company.

In summary, we see that underlying demand for our offering remains steady and we have recently received data demonstrating a modest rebound in COPD diagnosis that we are projecting to continue in 2023. We expect supply visibility to continue to improve, and as such, we are providing revenue guidance for the full year. In addition, we are confident that the evolution of our channel strategy to support our patient-centric vision will allow us to serve more patients, drive growth and [indiscernible] (00:14:10) back to profitability at the end of 2023.

I look forward to talking further about our commercial and growth strategy at our event next Monday.

I will now turn the call over to Kristin. Kristin?

Kristin A. Caltrider

Executive Vice President and Chief Financial Officer, Inogen, Inc.

Thank you, Nabil, and good afternoon, everyone. Total revenue for the fourth quarter of 2022 was $88.1 million, 15.3% year-over-year growth in the fourth quarter of 2021. The increase was driven primarily by higher US business-to-business sales and rental revenues, partially offset by lower direct-to-consumer sales. For the fourth quarter, foreign exchange had a negative 240 basis points impact on total revenue and a negative 890 basis points impact on international revenue. On a constant currency basis, fourth quarter total revenue increased 17.7% over Q4 2021.

Looking at the fourth quarter revenue on a more detailed basis, domestic B2B revenue increased 164.6% to $27.2 million in the fourth quarter of 2022, compared with $10.3 million in the comparable period of 2021, as we prioritize fulfillment of open orders and serve new ones. It is important to note that the domestic business-to-business revenue was down considerably in Q4 2021 due to supply constraints that limited shipments to the channel. Rental revenues increased 14.4% to $14.9 million in the fourth quarter of 2022 from $13 million in the fourth quarter of 2021 as the investment in our prescriber initiative continues to bear fruit, resulting in increased billable patients.

Rental revenue was also positively impacted by higher Medicare reimbursement rates and higher billable patients as a percent of total patients on service. International B2B sales increased 3.1% to $20.7 million in the fourth quarter of 2022 from $20.1 million in the comparable period of 2021. As Nabil mentioned earlier, we received our EU MDR certificate in December, enabling us to commercialize our new product Rove 6 in select countries in Europe. Direct-to-consumer sales decreased 23.4% to $25.3 million in the fourth quarter of 2022, from $33 million in the fourth quarter of 2021, driven primarily by lower volume due to fewer inside sales representatives and higher mix of untenured sales reps as compared to the prior period.

Moving to revenue on a full year basis. Total revenue of $377.2 million increased 5.4% compared to 2021. The year-over-year increase was primarily due to higher international business-to-business sales and rental revenue, partially offset by declines in US business-to-business and direct-to-consumer sales. For the full year, foreign exchange had a negative impact of 150 basis points and a negative 680 basis point impact on international revenue. On a constant currency basis, full year total revenue increased 6.9% over 2021. International B2B sales increased 27.3% to $101.2 million for the full year 2022 from $79.5 million in 2021 as we prioritize shipments to Europe ahead of EU MDD certificate expiration in Q2.

Additionally, when the EU MDR certificate was received in December, we were able to begin satisfying demand for the new Rove 6 units in Europe. Rental revenue increased 22.5% to $56.7 million for the full year 2022, from $46.3 million in 2021 due to the continued success of the prescriber team in generating higher rental patients on service. Additionally, we have realized higher billable patients as a percent of total patients on service and benefited from higher Medicare reimbursement rates. Domestic direct-to-consumer sales decreased 5.4% to $133.3 million for the full year 2022 from $140.9 million in 2021, driven by lower volume due to a lower number of sales representatives and an increased percentage of non-tenured sales reps, partially offset by increased average selling prices.

Domestic B2B revenues decreased 5.8% to $86 million for the full year 2022, compared with $91.4 million in 2021, primarily due to supply chain constraints that limited our ability to meet all customer demand during the first half of the year, partially offset by higher average selling prices. Now on to discuss our gross margins, sales revenue gross margin was 29.3% in the fourth quarter of 2022, declining 1,990 basis points from the comparable period in 2021, driven primarily by channel mix, increased material costs, including premiums paid for semiconductors and higher warranty costs. This was partially offset by higher manufacturing productivity from increased production volume. Rental revenue gross margin was 53.9% in the fourth quarter of 2022 versus 56.8% in the fourth quarter of 2021, a decline of 290 basis points. The margin compression was primarily driven by increased service costs and device recovery, partially offset by higher Medicare reimbursement rates.

For the full year, sales revenue gross margin was 38.3% in 2022, declining 980 basis points compared to 2021, driven primarily by higher premiums paid for components. In 2022, the company expensed $23.8 million of higher material costs associated with open market purchases of semiconductors required to manufacture batteries and motherboards used in our portable oxygen concentrators. In addition, we experienced higher warranty costs and an unfavorable channel mix, partially offset by the benefit of higher selling prices. Rental revenue gross margin was 54.3% in 2022, declining 310 basis points compared to 2021. The margin compression was driven by increased service cost and device recovery, partially offset by higher Medicare reimbursement rates.

Moving on to operating expense. Total operating expense increased to $88 million in the quarter, compared to $45.3 million in the fourth quarter of 2021, excluding a one-time $52.2 million expense associated with a loss on disposal of an intangible asset. Operating expenses decreased to $35.8 million, primarily due to lower general and administrative and sales and marketing costs, partially offset by higher research and development costs.

Going into more detail on our expenses in the fourth quarter, we have continued to invest in research and development with a total spend for the quarter of $5.9 million, an increase of $1.3 million versus the fourth quarter of 2021. The majority of this increased spend was for product development and clinical research activities.

For sales and marketing, we had a total spend for the quarter of $28.6 million. The $1.1 million decrease in spending was primarily related to reduced media and advertising expense and lower commissions and bonus expense, partially offset by increased spend on the prescriber initiative, professional fees and consulting. And finally, we incurred $1.3 million for general and administrative expenses in Q4, representing a $9.6 million decrease as compared to the prior period. This was primarily due to a $12 million increase in the benefit from the change in fair value of the New Aera earnout liability, partially offset by increases in personnel-related expenses aimed at rebuilding core capabilities at the company.

For the full year 2022, total operating expenses increased to $238.8 million, compared to $167.2 million in 2021. Excluding the aforementioned $52.2 million loss on disposal of an intangible asset, operating expenses increased to $186.6 million. Going into more detail on our annual spend, we have continued to invest in research and development with a total spend for the year of $21.9 million, inclusive of $7.8 million in amortization of intangibles related to the TAV technology. A $5.4 million increase in spend versus 2021 was used to bolster our product development capability and build a dossier of clinical evidence in support of our current and future products.

For sales and marketing, we had a total spend of $120.8 million. The $8 million increase was primarily related to [ph] scaling up (00:24:38) the new prescriber team, as well as professional and consulting fees, partially offset by lower commissions and bonus expenses and media and advertising costs. And finally, we incurred $43.9 million for general and administrative expenses. The $6.1 million increase was primarily due to higher employee-related expenses, consulting and legal fees. These increases were partially offset by a $3.8 million increase in the benefit from the change in fair value of the New Aera earnout liability and a decrease in officer transition costs.

In the fourth quarter of 2022, we reported a net loss of $56.6 million and a loss per diluted share of $2.47. On an adjusted basis, we reported a net loss of $13 million and an adjusted loss per diluted share of $0.57. Adjusted EBITDA was a negative $10.6 million. For the full year 2022, we reported a net loss of $83.8 million and loss per diluted share of $3.67. On an adjusted basis, we reported a net loss of $26.2 million and an adjusted loss per diluted share of $1.15. Adjusted EBITDA was a negative $13.5 million.

Moving on to our balance sheet. As of December 31, 2022, we had cash and cash equivalents of $187 million with no debt outstanding. Accounts receivable balances increased to $62.7 million as of December 2022, driven by a large increase in B2B shipments in the quarter. We continue to make investments in the fourth quarter in our inventory, incurring additional premiums for semiconductors purchased on the open market, but not yet sold in finished goods. These items reside on the balance sheet as prepaid expense and other current assets and inventory. As of December 31, 2022, the value of premium components in our inventory and prepaid balances were $10.1 million and $7 million respectively. Additionally, intangible assets and inventories were reduced by $51.5 million and $0.5 million respectively, as a result of the loss on disposal of intangible assets.

I will now turn to our financial outlook. As Nabil mentioned earlier, we are providing annual revenue guidance for 2023. We are expecting total company revenue to grow in the low- to mid-single digits. As we continue to drive towards profitability, we anticipate reaching a positive adjusted EBITDA by the fourth quarter of 2023. To further help provide context for modelling, given the time to ramp sales rep capability and productivity in the DTC channel, we are expecting the first quarter to be the lowest revenue quarter of the year and below levels that we saw last year due to the continued evolution of the DTC model, as well as returning to normalized ordering patterns in the B2B channel. We expect DTC cash revenues to be soft in the first half of the year, but to recover in the second half as the efficiency and productivity efforts are realized. We are expecting revenue growth to ramp in the back half of the year as we gain reimbursement in France and sales in the B2B channel continues to normalize.

In addition, as supply gets better in 2023 and we deplete premium priced components, we expect to see margin expansion in the back half of the year, as price increases remained and production volumes are increased. Improvements in our bottom line would also come from cost management efforts, which allow for the investment needed to drive medium- to long-term growth while limiting expansion of our operating expenses. As we look to 2023, we expect to reach positive adjusted EBITDA by the fourth quarter. We are judiciously managing operating expenses to improve our bottom line while continuing to invest in our key initiatives, which set us up for long-term revenue growth and profitability.

And with that, we will be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. And at this time, we'll be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Robbie Marcus with JPMorgan. Please proceed with your [audio gap] (00:30:10).

Q

Hi. This is actually [ph] Lilly (00:30:14) on for Robbie. Thanks so much for taking the questions. And maybe just starting with guidance, can you talk through what's assumed in terms of disruptions from supply or macro challenges, and any potential COVID headwinds, and what takes you to the high or low end of the range?

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

[ph] Sure, Lilly (00:30:33), thank you for the question. I'll start and Kristin can add some commentary. So the range, as you saw, includes [indiscernible] (00:30:41) there is remaining DTC scaling and productivity that we are working on that will continue to ramp through the first half of the year and then improve in the back half of the year. That's baked into the range as well as potential supply chain interruptions that remain. We're continuing to work hard to get visibility through Q3 and then into Q4. But at this point in time, early in the year, we are remaining a little cautious in terms of leaving the range a little bit wider with the hope of tightening it as we progress and we get into the quarters and the year.

Kristin A. Caltrider
Executive Vice President and Chief Financial Officer, Inogen, Inc.

A

I think, [ph] Lilly (00:31:17), all I would add to that is there are a few things that we think could impact the number. First of all, foreign currency, depending on where the US dollar, Euro, the currency exchange rates go, that could be one impact. As Nabil mentioned, supply chain that could drive an impact one way or the other. And then finally, the timing of the reimbursement in France also could have an impact.

Q

[indiscernible] (00:31:48). That's helpful. And maybe just as a follow-up. There's obviously a lot of moving pieces here with supply, EU MDR. I know you guys have taken price to offset some of these headwinds. So, I'm just trying to get a sense for how underlying volumes and demand are doing. So any color you could share there would be helpful. Thanks so much.

Kristin A. Caltrider
Executive Vice President and Chief Financial Officer, Inogen, Inc.

A

Well, as we look to our forecast, we are projecting increased volume. So, we believe in the underlying demand. And we are – again, as we gave a little color on the timing of the quarters, we believe it will be a little softer in the first half, but growing in the back half.

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

And, [ph] Lilly (00:32:34), the one thing I would add is as we rebalance our channel strategy, there – as you said, there are moving pieces, but we're confident that the focus and where we're putting is in terms of looking through all the channels, as we said from a how we serve the patient, one has a role to play. But overall, like Kristin said, we expect volume to go up and the demand to remain steady.

Q

Great. Thank you.

Operator: Our next question comes from the line of Matthew Mishan with KeyBanc Capital Markets, Inc. [ph] Please (00:33:09) proceed with your question.

Brett Fishbin
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, guys. This is Brett Fishbin on today for Matt. Thanks for taking the questions. Just wanted to follow up on a couple of the potential near-term growth headwinds you guys discussed maybe a few months ago. I'm not sure like how much they came up on the call today. So first, look around, the issue around B2B customer access to capital. Are you still seeing that as a headwind or has that gotten better a little – a little bit faster?

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

Yeah. Thank you, Brett. I'll take this. So we continue to see some of that still materializing. That's why we actually in the prepared remarks said returning ordering patterns to normal. So we started working and [indiscernible] (00:33:49), like we said earlier in terms of landing, where the normal patterns should be in Q4. There are remaining headwinds and challenges depending on the size and the complexity of the customer in terms of access to capital. But we continue to work through some of these challenges as the year progresses.

Brett Fishbin
Analyst, KeyBanc Capital Markets, Inc.

Q

All right. Make sense. And then also just on the topic of, you know, seeing some of those B2B customers opting to purchase the lower quality competitive products at a discount, has that continued to play out or, you know, do that also connect to some of the previous commentary?

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

Yeah. That's a great question. So let me talk about how sort of the cycle works. So people during the supply shortages on our side migrated to some competitive offering, I think the competitors at that time also availed themselves of the opportunity to offer aggressive pricing so they can probably grab a bigger share of the market. The feedback that we have and the interactions that we have today is B2B customers are returning, wanting to have a conversation about how they actually get back to ordering from Inogen because of their dissatisfaction with either the quality and/or the supply assurance on the competitive side.

So ongoing – of course, within that, there is ongoing discussions about the competitive pricing, and we continue to work and focus on the total cost of ownership of our device versus the acquisition price. Because if you compare acquisition prices, of course, we're in an unfavorable situation, but most of our B2B customers, especially the more – the larger and the more complex ones, understand that there's much more to the acquisition price and the total cost of ownership, and they understand that we are positioned with the quality as well as the durability of our devices and the demand from a brand perspective to be advantaged versus our competitors. But as I said, it's a cycle and people work through it. We remain very judicious and cautious about monitoring competitive activity. It's not a major red flag, but we will work through it.

Brett Fishbin
Analyst, KeyBanc Capital Markets, Inc.

Q

All right. Great. That sounds promising. And then, last one around some of the headwinds and then just a quick – one more quick follow-up after that. So the last one was really around seeing some headwinds on the DTC – on the direct-to-customer side, given some of the inflation headwinds. And just given the uncertainty around a potential recession wondering how you're factoring that into the initial guidance and what you've seen over the last few months?

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

Yeah. And the guidance, we have – definitely like we said in the prepared remarks, we factored the time it takes us to ramp the DTC efforts. I just want to stress again that we are internally organizing slightly differently with learning and reapplying the pilots and that took a little bit of time for it to materialize. We are looking for the first half of 2023 for us to scale and [ph] stand up the pilots fully (00:36:41), the headwinds from DTC are factored into the guidance to your question earlier.

Brett Fishbin
Analyst, KeyBanc Capital Markets, Inc.

Q

All right. Great. And then lastly for me, just wondering if you could provide any more level of color around the cadence. I think you noted that 1Q would probably be the lowest quarter, but just a sense of how that might compare sequentially or if you're – just like are you expecting any level of growth in the first half or first quarter? How should we be thinking about that? Thanks very much.

Kristin A. Caltrider
Executive Vice President and Chief Financial Officer, Inogen, Inc.

A

Hi, Brett. I think I'll take that one. We are trying to give color as to the lowest quarter and potentially not being a growth quarter. So Q1 will likely be lower than what we achieved in Q1 of 2022. But we do believe Q2 will ramp from there and the summer months are the better months for us, and we'll start to see some of that kick in.

Brett Fishbin
Analyst, KeyBanc Capital Markets, Inc.

Q

Yeah. Thanks for taking the questions.

[indiscernible] (00:37:44)

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

Just a couple of things for your consideration. So, one is like Kristin mentioned, there is DTC reorganization or evolution headwinds. There is also on the B2B, you asked in the previous question, a return to normal ordering pattern. But also I think as implied by our prepared remarks, we are looking at the channel strategy and the mix while remaining focused on DTC to actually continue to drive towards profitability, at least at the adjusted EBITDA line by the end of the year. So there is a judicious effort to also look at the sales force as well as the makeup and the mix of the sales forces.

Brett Fishbin
Analyst, KeyBanc Capital Markets, Inc.

Q

All right. Thanks very much for taking the questions.

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

Thank you, Brett.

Operator: Our next question comes from the line of Mathew Blackman with Stifel. Please proceed with your questions.

Mathew Blackman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Good afternoon. Thanks for taking my question. I'll limit myself to one. Maybe just a follow on. I just want to make sure I wrap my head around the DTC headwinds. It sounds like you're talking about trying to scale a pilot program rather than maybe seeing outsized attrition. Just maybe a little bit more color of what happened and I'm asking you sort of relative to some of the metrics that you've shared over the last 18 months where productivity seem to be ramping nicely. Maybe just compare or contrast what you'd seen over the last 18 months versus what manifested here in the fourth quarter. And I guess the other point is why does it improve in the second half? Why is six months enough time for you to stand everything up? And I'll leave it at that. Thanks.

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

Yeah. Perfect. Thank you, Mat. I'll take the question. So, [ph] Mat (00:39:30), let me start with the productivity numbers. Next Monday, we actually are going to share the productivity – this coming Monday, we are going to share the productivity numbers that we shared before in multiple forums while we met with you at JPMorgan. There continues to be positive productivity traction and the factor that we actually are putting into the number around DTC is about honestly letting the attrition get a certain number of sales reps. You asked about attrition. It's planned more than it is being [ph] involuntary (00:40:04). And then we will discuss roughly where we would land in terms of the size of the sales force.

Again, I'm going to connect it back to balancing and optimizing the channel strategy and the investments for us to get to the right growth level and getting back to profitability at the end of the year. The second part of your question is, okay, why do we have the confidence that actually it will ramp-up in the back half of the year? I think throughout the pilots, we've been able to isolate the key variables, and through piloting and testing and learning, we know exactly what are the variables that need to be focused on moving forward with the right sales force and the right sales discipline, meaning the right size and the right sales discipline and execution, we are confident that we can actually ramp back up in the back half of the year.

Mathew Blackman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

All right. Thank you so much.

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

Thanks, Mat. Thanks, Mat.

Operator: Our next question comes from the line of Mike Matson with Needham & Company. Please proceed with your question.

Mike Matson
Analyst, Needham & Co. LLC

Q

Yeah. Thanks. I want to ask a few on the new products, the Rove 4 and Rove 6. So, one, I guess, how they compare to the prior models? And two, are you planning to sell both of them? I'm a little confused about what markets they're being sold into. It looks like in the press release originally one was for Europe and one was for the US. And why is that? And then, is there any kind of benefit to gross margin from these? Are they lower cost manufacturing or anything like that?

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

Okay. Thank you...

Kristin A. Caltrider
Executive Vice President and Chief Financial Officer, Inogen, Inc.

A

Mike.

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

Thank you, Mike. I'll take that. So let me go back to the regulatory strategy to start with. So in the initial stages, the two products are aimed at different markets because of how we actually went through our regulatory strategy to maximize the ability to get approvals on time. So Rove 6 was actually went through the EU MDR and some of the changes in that product address your question about differentiation, the improvements in the product were required for us to clear EU MDR versus what was previously accepted in the MDD. So the changes are not significant, but they are noticeable to the user and that is an upgraded G5 if you want to call it that. Over the span of the year, we will actually apply to get an approval for Rove 6 in the US also, even though we started with the approval in Europe and we're selling it there.

On the flip side, Rove 4 was a 510(k) FDA application that we secured clearance on and that is a new and improved G4. So it has one more setting, almost in the same size and [indiscernible] (00:42:46). So we believe that, that will allow for a opening up of the number of patients that we serve. And this is the sweet spot there is people that want – that are afraid of running out of settings, but they want still the most portable and smaller POC base. And from a portfolio perspective, there is consideration and discussion now. We haven't finalized because the [ph] losses (00:43:11) in the back half of the year for premium pricing on Rove 4. But, in general, there is always consideration on pricing hygiene. No matter if it's a new product launch and/or the existing portfolio that we will continue to manage and evaluate during the year. So, Rove 4 starts in the US, eventually goes to Europe. Rove 6 starts in Europe, comes back to the US. So, it will be available in the near future in both markets.

Mike Matson
Analyst, Needham & Co. LLC

Q

Okay. Got it. And then – I joined the call a little late. Apologize if you touched on this in the prepared remarks. But the open market purchases of the components, I mean it sounds like that was still happening even into the fourth quarter. So, do you have any visibility into when you can get back to your normal contracts with your suppliers?

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

A

Yeah. Yeah. Great question, Mike. So, let me talk about. So, we continue to meet with the large – Mike, let – we continue to meet with the larger suppliers to try and get more visibility throughout the year. We have meetings that are happening next month. We've seen improved schedules in terms of shipping and commitments. We're trying to get the full visibility till the end of the year. We expect that situation to continue to improve throughout the year and to start sort of coming down towards Q4. In the meantime, I want to address the question that you raised in terms of the fact that we bought intentionally in Q4 on the open market certain quantities because this visibility we're talking about has just started happening recently, in the last four, five weeks.

When we were sitting in our seats in Q3, Q4, looking forward and not having the clarity, we made a strategic decision that we will incur the extra cost because eventually it's going to burn off on our – off our balance sheet and be invoiced. And we will actually secure supply assurance more than worry about the margin at that point in time. Moving forward, there seems to be more optionality in terms of how we manage this and we are hoping that it will continue to come down, hopefully by the end of the year and we return to normal next year early.

Mike Matson
Analyst, Needham & Co. LLC

Q

Okay. Got it. Thank you.

Operator: And we have reached the end of the question-and-answer session. And I'll turn the call over to Nabil Shabshab for closing remarks.

Nabil Shabshab
President, Chief Executive Officer & Director, Inogen, Inc.

Thank you. I'm pleased with the excellent progress that we have made in 2022 to manage and mitigate supply disruptions, react quickly to address macroeconomic headwinds while continuing to transform our business, drive commercial productivity, and develop an innovation pipeline and clinical evidence. We believe that 2023 is an important year with the evolution of our commercial strategy, the launch of new products, and continued work on our innovation pipeline, coupled with judicious management of our operating expenses.

We see underlying customer demand, a promising horizon of market opportunities, and we are building a solid foundation for long-term sustainable growth and return to profitability. As I conclude, I would like to thank our investors for your support and your interest in Inogen. I would also like to recognize and thank the Inogen team for their continued dedication and hard work. I'm extremely proud of our collective efforts to progress our business so that we can fulfil our purpose of improving patient life through respiratory care. I look forward to discussing more details about our growth strategy on Monday at our event in New York. Thank you so much. Have a good day.

Operator: And this concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.