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DMTK.OQ - Q1 2022 DermTech Inc Earnings Call

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## PRESENTATION

### Operator

Good day, and thank you for standing by, and welcome to DermTech's First Quarter 2022 Financial Results Call. (Operator Instructions).

And I will now hand the call over to Mr. Steve Kunszabo. Please go ahead.

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### Steve Kunszabo; *DermTech, Inc.; senior Director, Investor Relations*

Thank you, operator. Welcome to DermTech's first quarter 2022 earnings call. Joining me on the call today are Dr. John Dobak, our President and Chief Executive Officer; and Kevin Sun, our Chief Financial Officer. Our call today will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements made on this call that do not relate to matters of historical fact are considered forward-looking statements. Forward-looking statements made during this call, including projections of future performance, are based on management's expectations as of today, and are subject to various factors, assumptions, risks and uncertainties, which change overtime. Actual results could differ materially from those described in such statements.

Several factors that may contribute to or cause such differences are described in today's press release and our most recent filings with the SEC, including our annual report on Form 10-K for the quarter ended December 31, 2021. And our quarterly report on Form 10-Q for the quarter ended March 31, 2022. We undertake no obligation to update these statements, except as required by applicable law. Our first quarter 2022 earnings press release and SEC filings are available on our Investor Relations website. A recording of today's call will also be available on our website later today.

With that, let me turn it over to John.

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### John D. Dobak - *DermTech, Inc. - President, CEO & Director*

Thank you, Steve, and thank you, everyone for joining us today. At the end of March, we attended the American Academy of Dermatology, or AAD, Annual Conference, which was in-person for the first time since the pandemic started. For me, it provided another data point that indicates we are breaking through and the genomics in dermatology continues to gain heightened awareness. An important transition for any company is to have its customers and industry experts begin to carry the message independently of the company's efforts. We saw this at the AAD conference with our DermTech melanoma test or DMT, being referenced or discussed in numerous clinical and scientific sessions that we did not organize.

We want to change the status quo of early melanoma detection through our non-invasive genomics platform enabled by our Smart Sticker and numerous independent clinicians are now joining our efforts. Also our booth had meaningfully greater traffic than past meetings and led to approximately 300 sales leads. Our consumer awareness push around the meeting also spurred approximately 100,000 site visits and over 33,000 find a specialist searches. We continue to increase the number of specialists in the database who are familiar with the DMT, and now have over 650 locations or an 89% increase from Q1 of 2021.

Yesterday was Melanoma Monday, and the start of melanoma awareness month, and the DMT was presented on the today show. The DMT will also be discussed in additional magazines and national news segments, and we've engaged with melanoma survivor influencers to increase awareness of the need for skin checks and the availability of the DMT. We will continue this significant marketing push through the month of May and are renewing our commitment to donate to skin cancer-focused non-profits when people make a pledge to get a skin check.

Q1 2022 was a record quarter for our core commercial metrics despite a soft start in January due to Omicron. We finished Q1 with approximately 14,370 billable samples, a 22% increase from the prior record just set in Q4. Assay revenue also increased to a record of \$3.5 million or an 18% increase from the prior Q4 record. We believe the large commercial scale-up we impended last fall that significantly redrew territories and sales reporting structure is now resulting in the growth we expected.

April was a strong month and continued the growth trajectory we saw in the second half of Q1 after Omicron subsided. We continue our efforts to expand into primary care networks, and our team is actively engaging with a variety of networks around the country. We have resumed training of physicians in the Florida network following the Omicron-wave delay and have now trained about half of the approximately 300 clinicians. We have deployed a sales rep into this network to drive more adoption and utilization is improving. We are also expanding our pilot with the Midwest network and have trained several new offices.

In addition, we are negotiating an agreement to pilot direct selling to primary care with a small contract sales team of approximately 15 to 20 inside and outside sales representatives. This group will call on primary care offices that we have identified to have a modest dermatology practice based on an insurance claims look-a-like analysis. The purpose of this selling pilot is to determine utilization metrics in primary care and the investment required to appropriately target this channel.

Turning now to our progress with payers. During Q1, we added a payer contract with approximately 1 million covered lives, bringing our total covered lives to approximately 91 million. This plan has a high concentration of covered lives in the Southwest region, so we should be able to monetize some of the existing healthy sample volumes in that region. We have ongoing engagement with large regional and national payers and continue to hear the supporting data for the DMT is compelling. We are also increasing our visibility with payers through advocacy with professional societies, physicians and patients.

We spent the last 24 months developing strong relationships with groups such as the Melanoma Research Foundation, the Melanoma Research Alliance and the AAD's SPOT Skin Cancer program, and we recently received an endorsement from the Melanoma Research Alliance. We are working to leverage these relationships to help drive policy and contract decisions with payers.

With the publication of the OptumHealth economic study in skin, which was published by the National Society for Cutaneous Medicine, we received a very strong editorial endorsement from the members of the society's Leadership Board, which includes key dermatology opinion leaders and several former AAD presidents. This endorsement summarized the clinical value proposition of the DMT and they concluded, and I quote, creating broad access and coverage to transformative diagnostic technologies such as the 2 GEP, which is how they refer to our DMT, is in the best interest of our colleagues, the healthcare system and most importantly, our patients. With this advocacy momentum building, we remain optimistic that we will achieve coverage in 2022 from at least one nationally recognized payer.

Turning to Telehealth. We continue to expand DermTech Connect, which is now available in 44 states that represent 95% of the United States population. DermTech Connect is a longer-term strategic initiative that we plan to invest in over time to raise awareness among potential patients. We believe this offering to be an important step toward improving patient access to skin cancer assessments through a network of independent dermatology clinicians.

Now moving to our pipeline initiatives. We continue to prepare to launch Luminate later this year with the hiring of our new VP of Consumer Products in the first quarter, we've completed additional consumer research that underscores product positioning as a non-melanoma precancer risk assessment tool. This product will detect acquired mutations and normal appearing centers exposed skin. Educating consumers on skin cancers other than melanoma and then offering a test to evaluate their precancer risk, skin cancer risk will allow us to have a unique and differentiated product offering.

Much of 2022 will be spent educating consumers and testing key messages, content and digital promotion tactics and pricing. We don't expect meaningful 2022 revenue contribution as these educational and testing activities could take place through early 2023. Our Carcinome pipeline product is intended to facilitate the assessment of basal and squamous cell skin cancers. We have identified a classifier for basal cell cancers and are now working on the final validation. Assuming this validation cohort confirms the assay performance, we will look to begin generating utility data as soon as possible. We continue to refine the squamous cell classifier and are demonstrating improvements to the overall performance. However, we have not yet locked down a final classifier that is ready for validation, testing and subsequent utility studies.

And finally, we continued the expansion of DermTech Stratum to provide research and development services to the pharma and academic research communities. DermTech Stratum includes services such as biomarker identification, new target identification, patient segmentation and bioinformatic support. We are pleased to have seen an increase in engagement with pharma collaborators during the last couple of quarters and signed approximately \$400,000 in new contracts during Q1. We are seeing a pickup in clinical trial activity and interest in our Stratum offerings, though activity is still below pre-pandemic levels.

In addition, we have identified a research use only product to differentiate atopic dermatitis from psoriasis with a high degree of accuracy and have initiated marketing of this assay through Stratum. We believe this product will have utility in confirming the diagnosis of psoriasis or atopic dermatitis for patient enrollment into drug development studies for the treatment of these 2 conditions, since up to 20% of patients in these development programs may be enrolled with an incorrect diagnosis. We'll also evaluate this product to determine if it may have utility as a clinical diagnostic test.

In summary, 2022 is off to a solid start hitting various all-time records. We expect to further realize the benefits of our scaled commercial organization with continued traction in the dermatology channel, which will drive the vast majority of our revenue growth in 2022. Nonetheless, we will continue to make investments to expand our commercial channels into primary care, the DermTech Luminate consumer channel, the DermTech Connect telehealth channel and our DermTech Stratum research channel.

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

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**Kevin Sun** - DermTech, Inc. - CFO, Treasurer & Secretary

Thanks, John. I'm going to jump right into our quarterly results.

Assay revenue for Q1 2022 increased 61% to \$3.5 million compared to \$2.2 million for Q1 2021. Total revenues for Q1 2022 increased 47% to \$3.7 million compared to \$2.5 million for Q1 2021. Q1 2022 ASP was \$245 per sample, a 5% increase compared to \$234 per sample in Q1 2021, and was down slightly on a sequential basis, which included seasonal impacts from resetting of deductibles. ASP improvement will continue to fluctuate as collection patterns can vary and may alter the trajectory from quarter-to-quarter. Our potential assay revenue that could be recognized from having broader payer coverage is still meaningfully higher than actual reported revenue.

Billable samples for Q1 2022 were approximately 14,370 compared to approximately 9,400 for Q1 2021 or a 53% increase. Medicare samples represented about 24% of our billable samples in Q1 2022, compared to approximately 17% in Q1 2021, and 23% in Q4 2021. We have additional opportunity to further penetrate the Medicare market since Medicare represents half of the total biopsies for melanoma each year. With approximately 3,240 unique ordering clinicians during the last 12 months, we penetrated 36% of our expanded initial target market of 9,000 dermatology clinicians and penetrated about 25% of the 13,000 total practicing dermatology clinicians.

We had approximately 2,040 unique ordering clinicians in Q1 2022 compared to approximately 1,200 in Q1 2021 or a 70% increase, and compared to approximately 1,800 in Q4 2021, or a 13% sequential increase. Our average quarterly utilization or average number of tests ordered per unique ordering clinician was 7.0 billable samples in Q1 2022, compared to 6.5 in Q4 2021 and 7.8 in Q1 2021. Overall utilization increased sequentially, even with the record of new quarterly ordering clinicians. Improved sales call frequency contributed to higher utilization rates of existing prescribers and offset lower utilization rates of new ordering clinicians who typically order less per month when they first start up.

Contract revenue decreased 40% to \$0.2 million for Q1 2022, compared to \$0.3 million for Q1 2021. Contract revenue continues to be highly variable and is dependent on the pharmaceutical customers' clinical trial progress, patient enrollment success and other factors. As of March 31, 2022, we had a maximum of \$4.0 million in potential remaining contract revenue related to our current agreements.

Gross margin for Q1 2022 was 4% compared to 21% for Q1 2021. The decrease in gross margin was largely driven by lower contract revenue and higher assay COGS during Q1 2022 compared to Q1 2021. Assay gross margin for Q1 2022 was 0% compared to 10% for Q1 2021, a negative 1% for Q4 2021. Assay gross margin decreased due to higher headcount related costs for annual raises and market adjustments, given the competitive local market for scientific tailwinds.

Sales and marketing expense increased 137% to \$15.4 million for Q1 2022, compared to \$6.5 million for Q1 2021, primarily due to additional head count and additional marketing investment, including digital media, direct-to-consumer advertising, professional promotion and additional travel costs. We expect sales and marketing expense to increase throughout 2022 as we recognize the full impact of our expanded sales force and increase our marketing spend to drive awareness of our technology.

Research and development expense increased 182% to \$6.3 million for Q1 2022, compared to \$2.3 million for Q1 2021. The increase was primarily due to higher payroll-related costs, higher stock-based compensation, increased clinical trial costs and additional lab supplies. We expect R&D expense to increase during the rest of the year as we ramp up our pipeline development efforts.

General and administrative expense increased 66% to \$8.6 million for Q1 2022 compared to \$5.2 million for Q1 2021. The increase was primarily due to higher payroll-related costs, higher stock-based compensation, higher audit and legal fees and additional facility related costs. We expect our general and administrative expense to increase throughout 2022 as we implement systems and infrastructure to support our overall growth.

Net loss for the first quarter of 2022 was \$30.1 million or \$1.01 per share, which included \$3.9 million of noncash stock-based compensation compared to a net loss of \$15.1 million or \$0.55 per share for the same period of 2021, which included \$2.2 million of noncash stock-based compensation and \$1.7 million of expense related to a non-cash change in fair value of the warrant liability.

As of March 31, 2022, our cash, cash equivalents, restricted cash and marketable securities totaled \$202.3 million. We are affirming our full year 2022 assay revenue guidance between \$22 million and \$26 million, which represents growth of 100% to 136% over 2021. The strong growth of key financial and operational metrics during Q1 is a testament to the solid foundation that has been built in the prior quarters, especially given a challenging pandemic environment. We look forward to executing for the rest of the year.

Now I'll turn the call back to the operator for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) We have our first question from Brian Weinstein from William Blair.

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**Brian David Weinstein** - *William Blair & Company L.L.C., Research Division - Partner, Group Head of Life Sciences & Healthcare Analyst*

I guess just to start out with -- on the utilization per doc, recognizing that, of course, there's new docs coming on. But can you just talk about where that was kind of versus your expectations with the sales force now kind of fully deployed and able to get to kind of a more normal efficiency? Can you just talk about what you think that utilization per doc should be doing throughout the year? Give us some context for how that could expand throughout the year.

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**John D. Dobak** - *DermTech, Inc. - President, CEO & Director*

Sure. I think in general, we are pretty pleased with it. We always expect a drop in utilization when we have a significant number of physician adds, which occurred. Physicians always start out kind of dabbling, I guess, and then with more calls from our sales rep, they -- and consistency of use, they begin to ramp up their utilization. So I would say we were actually pretty pleased given the add, the new position adds that we had. And we expect that to -- we expect it to be kind of up and down, but with a general trend upward, because we will be adding more docs throughout the year, and we'll kind of go through those cycles. But we also saw that we are driving overall utilization in general through existing customers, and that's what we expect to see primarily. Kevin, do you have anything to add?

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**Kevin Sun** - *DermTech, Inc. - CFO, Treasurer & Secretary*

Yes, certainly. We've talked before about the shift in our strategy from going deep within the current base to now going broad. And so while we are focused on the ability to schedule a full day of sales calls is still challenging. We've talked about that before, too, where to really round out the day, reps historically would do drop-ins, which that piece is something that has still not come back, we have to be very diligent about scheduling with sales call. And so as we're filling up the day for our reps, they do target and try to get a lot of the new reps, new sales leads and doctors on board, but when they're filling out the day, they'll still call on existing doctors.

Like John said, I think we're very happy, it's probably a little bit better than we expected at this point, especially given that there's new reps, this is -- Q1 was the first quarter that they're really getting going. And as John said, too, we expect that overall utilization will kind of pick up throughout the year as now we've got the new base of ordering doctors and then we'll keep calling on existing doctors kind of going forward.

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**Brian David Weinstein** - *William Blair & Company L.L.C., Research Division - Partner, Group Head of Life Sciences & Healthcare Analyst*

And where do you think access is right now relative to pre-pandemic or relative to your expectations? Also, where do you think patient visits are in general at this point in office?

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**John D. Dobak** - *DermTech, Inc. - President, CEO & Director*

So I think in general, patient visits are pretty well recovered. I think we saw some data recently where it might be down in sort of the 5% range. And even some months, it had picked up a little bit, so I think the patients are returning. Access by reps is still not at pre-pandemic levels, it is improving, but we're still down from the number of calls per day we would like our sales reps to make. And I think a lot of calls now have to be scheduled. They try to do drop in calls between scheduled calls, and that's really kind of where the challenges remain, it's just those drop in calls.

As we've talked about in the past, we have various things we're doing from peer-to-peer selling, which helps offset some of those changes with dinner events and things like that where we get a KOL or one of our speakers to speak to other physicians about it. And our DermTech degree program, which is about educating the whole office about the use of our platform. Those are ways we kind of come back there. It somewhat reduced call frequency that we saw -- that we see with -- as we're coming out of the pandemic.

**Brian David Weinstein** - *William Blair & Company L.L.C., Research Division - Partner, Group Head of Life Sciences & Healthcare Analyst*

Okay. And then one more for me, if I could squeeze one in here. We hear a lot about, you guys talking about telehealth, as well as the primary care opportunities here, and recognizing that they're still very early and still playing out. But is there a way for you to frame what the opportunities are here? And if I was thinking about those 2, is there one that is more of a near-term driver or one that's kind of a bigger opportunity longer-term? Just can you put a little meat on the bone for us to kind of help us understand how big these potentially could be over time?

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**John D. Dobak** - *DermTech, Inc. - President, CEO & Director*

Sure. I mean, I think the more relevant sort of near-term opportunities in primary care. And as we've talked about for the last quarters, we've been making inroads into that segment. As we've also talked about, the challenge with primary care is not that they don't believe in genomics, they've adopted genomics, and they also believe in what we're doing. It's just that they're taking care of a lot of other things. And so the question really is, what is the utilization rate within the primary care office? And how do you drive that utilization rate from a certain sales force effort, meaning, i.e., calls and number of physicians that a rep would have in a territory for primary care.

The market would obviously be massive. I mean with 250,000 primary cares, if you could get after all of those and you could drive even a few tests per month through that channel, assuming there was a return on investment for that sales force, there's clearly would be a big opportunity there. We have to time that with our ASP growth because to make those investments and get the return on the investment, you want to have the right coverage and the right ASP, so you get a return on that investment. Those are all the variables we're trying to understand. I'm sorry, we got some jets overhead if you hear that. We live near the Miramar Air Force Base. We're glad they're up in the air, but they caused a little background noise. Anyway, it's obviously a big opportunity.

On telehealth, we think that's a long-term shift in healthcare. The challenge with any telehealth, and you've probably heard about some of the dynamics occurring in that market is really about customer acquisition and just the sheer competitiveness in that whole area. That's why we're trying to synergize that offering with our other marketing initiatives like Find a Specialist. We do think it's a long-term opportunity, that's why we expanded all those states. We are seeing improvements in the overall use of that platform. We haven't really stepped fully on the accelerator, because the acquisition cost to get a sample through that particular channel are prohibitively high still. They are coming down, there will be a point when that number comes down low enough where we have to say, it's time for us to invest more into that channel, particularly as that cost maybe start to near the customer acquisition cost for a sales rep, for example.

So those are the metrics we're looking at to decide how heavily we invest in that telehealth. But we believe it's a long-term shift that's going to occur and we want to participate in that, and that's why we're laying the foundation.

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**Operator**

We have our next question from Max Masucci from Cowen.

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**Stephanie Yan** - *Cowen and Company, LLC, Research Division - Associate*

This is Stephanie Yan on for Max Masucci. If you could give us -- if you first give us a sense on how your recent conversations with commercial payers have changed following the official publication of the cost benefit analysis in skin? And more specifically, have you found that the publication is resonating better or worse with specific types of commercial payers, for instance, regional payers, small national payers or large national payers?

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**John D. Dobak** - *DermTech, Inc. - President, CEO & Director*

I think it's yes to all the above. The publication is definitely resonating. I think that editorial, which is not technically evidence, but is a strong endorsement, is also resonating, that goes along with that publication. And all I can say is that we like the progress we're seeing with the payers, they're definitely leaning in, they're listening to our story, we can't predict exactly when they're going to come on board. We just believe that it's

not a question of if, but rather the timing and the when they come on-board. And we have a tremendous data package, they are realizing that. And overall, the progress is happening there, both regional and national. And we expect to have more favorable news flow in that regard throughout the year, and we're still maintaining our goal to bring on that national payer, a nationally recognized payer for sure.

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**Stephanie Yan** - Cowen and Company, LLC, Research Division - Associate

Got it. That's helpful. And then also, last quarter, you highlighted that with set of electronic ordering at 300 locations, with an additional 200 in the works. Can you mind giving us an update on the number of locations with the electronic ordering? And have you seen any increase in orders or the test in implementing the ordering feature?

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**Kevin Sun** - DermTech, Inc. - CFO, Treasurer & Secretary

Yes, we have a little north of 360 locations that are now integrated. So about 60 just in the last couple of months since the last call that we talked about. And so we have about 150 so additional that are in the pipeline to be integrated here in the coming months. Whenever we do have those integrations, we do see increases in ordering patterns from the doctors who integrated, and that's a big reason why we're doing it. It's the efficiency for the physician's practice and the ability to send them in, in a way that is within their normal workflows. So that's something I think that's common within dermatology and it's something that we're seeing as well. So we are seeing that pay off between improvement utilization.

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**Stephanie Yan** - Cowen and Company, LLC, Research Division - Associate

Got it. That's helpful. And if I could squeeze in one more. So with respect to your efforts in the primary care setting, do you have any plans to increase your targeted contract sales team as you further penetrate this setting? And if -- are there any challenges that you can highlight with your efforts with both the Florida network and the pilot in the Midwest?

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**John D. Dobak** - DermTech, Inc. - President, CEO & Director

So we -- the investments we're making there until we get the data back, if it makes sense, and we believe there's a return on that investment by going directly after primary care, we will make that investment. That's why we're running this pilot with the contract sales team. We think there is a -- the reason we're doing the contracts is, we think there is an opportunity there. We have managed to call on some of these doctors that have this modest dermatology practice in the primary care setting, and we've had some success in getting them interested in the products. So now we want to make a more concerted effort there. So that's just -- the more we invest there is really a function of the outcome of that particular direct selling effort.

On the IDN, we -- as we talked about, we have built up a team. They have a deep pipeline of opportunities there. The offering resonates in general with these IDNs, who are really trying to save cost and that occurs often by avoiding outside referrals to specialists. So -- and that's more of a top-down sale as we have discussed in the past, where you're going more at the executive level. You got to get buy in there before they allow your sales representatives to even call on their physicians. So that's a different type of sale, and we're pretty much committed to that strategy, and we are making progress on that strategy, and we'll continue to do so, because we believe there is a good return there going after those networks that we've talked about in the past.

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**Operator**

We have our next question from Alex Nowak from Craig-Hallum Capital.



**Alexander David Nowak** - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Just curious how important was the in-person AAD meeting and also the national sales meeting here in order to get the marketing down with clinicians and/or logistics. Just given the bigger sales force now and they haven't been in person for some time. Just any trends that you could share on how physician onboarding utilization began to trend later in March, and then you say you go after those meetings.

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**John D. Dobak** - *DermTech, Inc. - President, CEO & Director*

Well, as I mentioned in my opening remarks, April, we continue to have growth over the second half of Q1. And is that -- I think it's probably related to that push we had at the AAD, and the enthusiasm we saw there. As we mentioned, we got a lot of leads through that. We had a tremendous marketing presence there. It dovetails nicely with our consumer digital marketing that we do. So I think what we saw -- personally what we saw in April is a result of that heightened awareness that occurred at the AAD meeting. The exact contribution, I don't think we've teased that out yet. But in general, we like the trends that we're seeing.

And as I would say to my team, 2 or 3 years ago, when you mentioned DermTech to a dermatologist, their blood could potentially boil, because they saw us as a threat. Now they lean in and say, "Hey, I got to learn about this. What can you tell me?" And it's definitely a shift from where we were a few years ago. And you saw that at the AAD conference, and I think we're seeing that now as we continue post that conference. And all the efforts we're going to do through May in the melanoma awareness month.

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**Kevin Sun** - *DermTech, Inc. - CFO, Treasurer & Secretary*

Yes. In terms of NSM, I think it was also important. I mean, getting the new pitch down, making sure that the marketing and the messaging is consistent and accurate, especially with all the new reps, that was a really important piece. So we did see some pickup in activity right after that national sales meeting kicked off. So we know it really energized the team. But I think, again, just getting people together in person after this long 2 years of limited kind of contact for many, many people, it's just rebuilding some of those personal connections and bonding that we as people need to do.

I think we saw that in December too, we mentioned the speaker bearer training that we held here in-person in San Diego. And again, it's just when you get the buzz going, getting people together in the room talking about something they're passionate about. It's something that's hard to replicate in a digital type of environment like Zoom and things like that. So I think all those in-person events are really helping and driving towards the expected growth that we're looking into for this year.

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**Alexander David Nowak** - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Yes, understood. On the payer side, do you think the NCCN Guideline is the Optum side of the trust data? Is that all going to be enough to force a change here? Or do you think another guideline like AAD is going to be needed or potentially another study? Just what's the potential of flipping payers, your national payer without potentially either another guideline change for the big publication?

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**John D. Dobak** - *DermTech, Inc. - President, CEO & Director*

That's a difficult question to ask. We're obviously trying to get in the AAD guideline. And I think we will be successful there, because they have even said that they want to harmonize with the NCCN guideline, and we're clearly there. The problem is the AAD guidelines don't get updated except once for every -- by every 7 years. And the last cycle was just a couple of years ago. Can we force them to do another review? That would be a challenge.

Data is always important. We hear that we have a very compelling data package, but that doesn't mean that we stop generating data, because clearly, whenever we have data, we bring that back to the payers. So we do have ongoing activity and studies, we have a large utility study going

on in -- that looks at the utilization with the TERT add-on that we've talked about in the past for the melanoma test. And I think we're working to try to get something out on that later this year.

And -- so we're always looking to build on our data set and never hurts to have more data. We're confident in the product in generating that data. And will that -- is one piece of data, they're going to be the one that tips the scales in our favor? We'll have to see. In general, we think this constant pressure using patient advocacy, appeals, all those things we've talked about that puts pressure on the payers, driving the overall volume. So this is clearly a technology that's here to stay. All the factors that are going to go into ultimately converting to a national payer win.

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**Alexander David Nowak** - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Yes. Understood. It's difficult to determine what's going to tip that payer over. Just last one, just on the inflationary environment going on right now. Has the company decided to make any separate causes here to new programs? And then maybe just some more detail of the forecast OpEx throughout the year, and then ultimately plans to preserve cash flow at this time.

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**Kevin Sun** - *DermTech, Inc. - CFO, Treasurer & Secretary*

Yes, we're not pausing any programs per se. I'd say what we are doing is making sure we have a very good lens and review process for assessing new programs. We've said it before, too. I mean one of our challenges, and it's a good challenge to have is that, we have so many different opportunities with our technology, but we do want to make sure we focus on high-value targets. So we're refining some of our processes, making sure we have good data. We're making good decisions based on assumptions and data that we can get together, and then being very prescriptive about it. So there is a saying we like to have around here is that, when it comes to investment, we don't mind investment, but we try to do is really squeeze out all the waste within systems.

And so we haven't seen a whole lot of inflationary pressures really. There is obviously some pressures around the wages and headcount growth just because of the employment markets. But other than that, we haven't seen a lot of real pressures for that. And then in terms of spend in OpEx guidance. So we are kind of spinning a few things right now. We'll have a better take on that, that we can disclose a little bit later. We mentioned the small contract sales force that we are kind of negotiating right now. Once we kind of bring that on and what does the effort look like around DT's marketing and primary care to accompany that effort, that's when we'll have a kind of a better idea what the OpEx and the spend looks like for the rest of the year.

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**John D. Dobak** - *DermTech, Inc. - President, CEO & Director*

I would just add, Alex, that as I said in my comments, the vast majority of our investment is to drive the DMT into that dermatology channel. We want to win there. We are winning there. We need to continue to win there. We are piloting these other investments that represent expansion opportunities, and that is primarily focused on the primary care. But we're making sure that we use the capital we have today to really make sure we drive and win within that dermatology channel, because that's where we see our strongest growth right now.

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**Operator**

We have our next question from Thomas Flaten from Lake Street Capital.

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**Thomas Flaten** - *Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst*

I wonder if you could comment on your success rate with appeals for non-covered payers. Are you getting better at it? Are they becoming more relaxed? I'm just curious if that's a potential offset on against ASP pressure?

**John D. Dobak** - DermTech, Inc. - President, CEO & Director

We are getting success on appeals. That's something that we have as kind of a corporate goal. And we measure it, because these processes can take a while. But I'd say that we're probably halfway to our goal for the year just 4 months into the year. So that is kind of one of the main pressure points for payers here, right. It's getting the volume, it's getting the data, and then it's also the transactional burden that the payers have to deal with the appeals. And again, we're seeing that when we get good medical records that support the utility of the test and the right diagnosis, then we can win on those appeals.

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**Thomas Flaten** - Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst

And if we use the Blues that you have under contract as a case study, so to speak. Could you maybe map out what -- from the time the contract is signed to when things are running smoothly, like what does that transition period look like? And are you able to quantify at all, what type of penetration you think you might have made into the market in the Blues plans where you do have coverage in a rate and all of that?

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**Kevin Sun** - DermTech, Inc. - CFO, Treasurer & Secretary

Yes, I'd say that it's different by the different plans. So some of the Blues plans were fairly efficient and up and running within a quarter or 2. There was another plan that had some hiccups in how they are processing things that took maybe an extra quarter. But other than that, once we kind of get up and running with them, call it within 3 quarters, then they are running efficiently. And then the penetration within the plans, again, it also varies based on the state. So Illinois is an example. That plan has a little north of half the covered lives in the state for the BCBS contract we have. Whereas in California, that plan has 3.5 million covered lives out of the, call it, 39 million or so within the state. So it's a much smaller proportion.

So I'd say we still have opportunity to penetrate further into those. And what's difficult is, it's not like we can necessarily target specific plans as we're trying to raise awareness with the sales team and call on various ordering doctors. So it just happens to kind of play out that when the doctor does order depending on which insurance that they have, that they'll -- it ends up being in one of these contracted Blues or not. It is a focus for us, we're trying to increase those proportions because that's another way we can increase the ASP. But it's just a little bit harder to control given how it dispersed now varying those plans can be.

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**Thomas Flaten** - Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst

And then just one quick final one for me. With respect to the facility transition at San Diego, could you talk a little bit about the status and then what we might expect to see relative to gross margins as all of that comes online as you facilitate that transition?

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**Kevin Sun** - DermTech, Inc. - CFO, Treasurer & Secretary

Yes. We have moved into our new fourth floor, which is our office space. That just happened last month. And then we're on track to complete the lab buildouts, which includes both the R&D and the CLIA labs by probably the fourth quarter with a move in around that time as well. We're working right now on what the impacts of the margins are, because obviously, if there is extra space, we talk that in Torrey Pines here, we've got capacity of about 150,000 or so tests per year. But in the new Del Mar labs, we'll have capacity for about 1 million tests per year.

So that we don't overburden margin in the near-term. We're currently strategizing ways to kind of separate -- segregate out and separate some of that space, so it doesn't kind of impact margin right away. We're kind of working on that because, again, construction is literally going on right now, we've broke ground just a month or so ago.

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**Operator**

(Operator Instructions) We have our next question from Mason Carrico from Stephens.

**Jacob K. Johnson** - *Stephens Inc., Research Division - Analyst*

This is Jacob on for Mason. So previously, you guys said that you expected about 9% of your volume growth in 2022 would come from the professional dermatology channel. But now that DermTech Connect has been granted access in 44 states. Does that change your view on this year's commercial blend or expected volume? And -- or I guess, are you guys anticipating it to maybe take a while for you have to gain widespread adoption?

**Kevin Sun** - *DermTech, Inc. - CFO, Treasurer & Secretary*

Yes. I think what we said was 90% to 95%. I'm not sure if you said 9% or 90%. But that's where we say the vast majority of the growth -- yes, the vast majority of our growth for the year is tied to the professional dermatology channel for the melanoma test. As John kind of mentioned, right, we do think telehealth is something that is part of the future. But because of the competition within it, we're not modeling in any significant growth there. So it's one of those things where now that we've just started leveraging the direct-to-consumer marketing we do to bring people to our website to find a specialist. We've updated our website so that right there as people are looking for specialists, they can also access the DermTech Connect landing page.

And if they're kind of in the process of trying to find a specialist, but they don't have one -- they can't find one that's close enough by or the next appointment is too far out in time, then they could go right there and try the DermTech Connect option. So we could be surprised, it could take off quicker than expected, we're just not building in that into our plans right now.

**Jacob K. Johnson** - *Stephens Inc., Research Division - Analyst*

Okay. Got it. And then can you just maybe provide any color on like how much you guys might plan to spend on like the advertising of driving that adoption like you're talking about that are already baked in like to your budget for this year? Or do you maybe expect cash burn to increase as a result?

**Kevin Sun** - *DermTech, Inc. - CFO, Treasurer & Secretary*

Yes. We bake in healthy spend on the DTC advertising side. We don't give specifics around it, but if you look at kind of the trends of what Q1 was for the sales and marketing line item, that's where we said we expect that line item to continue to increase over time, which will include both ramp-ups and efforts in marketing campaigns as well as just the full burden cost of the expanded sales force. And again, what we're trying to do right now is, just leverage the current DTC spend that we have to go direct people to Find a Specialist. If that does start to pay off with additional telehealth type of sample volume growth, we could consider it, but I think that's where we would just need to kind of see how it plays out for a little bit before we formally dedicate some additional capital there.

**Operator**

There are no further questions at this time. I will turn the call over back to the presenters. Thank you.

**Kevin Sun** - *DermTech, Inc. - CFO, Treasurer & Secretary*

Thank you again for everybody for joining us on the Q1 earnings call. We had a record-breaking quarter. We look forward to being able to execute on the future, and we feel like the foundation has been firmly set for the rest of the year. Thank you for your time.

**Operator**

Ladies and gentlemen, this concludes today's presentation. You may now disconnect. Thank you.

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