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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to DermTech's fourth-quarter 2023 financial results call. (Operator Instructions) Please be advised that today's conference is being recorded. I would like now to turn the conference over to Steve Kunszabo. Please go ahead.

Steve Kunszabo - *DermTech Inc - Senior Director, Investor Relations*

Thank you, operator. Welcome to DermTech's fourth-quarter 2023 earnings call. With me on today's call are Bret Christensen, 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 statements regarding projections of future performance or financial outlook of DermTech, the performance, patient, benefits, cost effectiveness, commercialization, and adoption of our products, and the market opportunity for our products are based on management's expectations as of today, and are subject to various factors, assumptions, risks and uncertainties, which change over time. 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 filed today.

We undertake no obligation to update these statements, except as required by applicable law. Our fourth-quarter 2023 earnings press release and SEC filings are available on our Investor Relations website. A recording and transcript of this call will be available on our website later today. With that, let me turn things over to Bret.

Bret Christensen - *DermTech Inc - President, Chief Executive Officer, Director*

Thank you, Steve, and thank you, everyone, for joining us. We are encouraged by the sustained improvement in many of our key performance indicators as they continued to head in the right direction throughout the second half of last year.

In the fourth quarter.

Asp for the DermTech melanoma test or DMT, grew 55% year over year. Test revenue increased 38% on the same basis. We also reported another all-time record high in the Medicare proportion of billable samples, which is about half of our addressable market and posted our highest gross margin in six quarters with the additional restructuring actions we announced last month, we may see a total reduction in annualized operating expenses of approximately $40 million compared to 2022. We will continue to emphasize reimburse test and growing revenue before I take you through a few commercial highlights, let me briefly revisit the key pillars of our story. First, we have a proprietary noninvasive skin genomics technology that has demonstrated it can enhance the standard of care for evaluating lesions suspicious of melanoma. Approximately 4 million surgical biopsies are performed annually to find nearly 190,000 new cases of melanoma. Dermatologists are working hard to provide great patient care, but their practice can benefit from new tools that supplement existing methods. The DMT. rules out melanoma with a 99% or greater negative predictive value or NPV and can support decision-making by clinicians.

Second, we and many leading clinicians believe there's a place for the DMT. and every dermatologic practice alongside established protocol as a starting point with dermatologists were aiming to identify the numerous instances in which health care provider doesn't want to biopsy a clinically suspicious lesion, but still wants to provide patients with peace of mind, our customers and patients can trust the results when they use our test and there is room for it to be integrated into the current melanoma care pathway. And third, we can introduce help we can reduce health care costs by providing genomic data to clinicians who can rule out the need for certain surgical procedures. While also providing a better patient experience on the payer front, all the insurance providers we brought on in 2023, which represent approximately 42 million new covered lives have started paying some claims for the DMT. were determined to continuously improve the onboarding and reimbursement process with payers to speed up the revenue benefit.

Finally, the Blues plan of Rhode Island and a Blues plan in the mid-Atlantic recently issued favorable coverage decisions for the DMT. in January. We were incredibly pleased to announce positive top line data for the Trust to study with a large cohort of more than 20,000 patients. The results reaffirm the DMC's real-world clinical utility with an NPV of 99.7% to rule out melanoma, which is meaningfully higher than other currently available methods for clinicians and patients. A high NPV delivers assurance that a suspicious pigmented lesion, which tested negative is unlikely to be melanoma. The study is an important way to continue to build trust with our customers, and we're actively showcasing the clinical value of DMT. in the field. The outstanding trust to study results will also allow us to reengage with insurance providers that don't cover our test. We're working to make the full study available at a peer-reviewed medical journal and expect to have an article published in the next several months. We will continue to reinforce our message around the clinical and health economic benefits of DMT with all stakeholders. Our visibility with payers also improves through state legislative efforts. Bills mandating insurance coverage of genomic testing or biomarker bills are gaining traction across the U.S. as lawmakers advocate for improving access to potentially life-saving genomic tests. Legislation has now been enacted in 14 states and eight additional states introduced biomarker bills in 2023 that are making their way through the legislative process.

Moving now on to our commercial business, where we continue to dedicate substantially all of our resources to growing reimbursed tests and boosting revenue. We now have two quarters behind us since we changed our approach, we believe it is evident. These changes have had a positive impact on our top line, but we're still refining our tactics as we learn more first incentive compensation for our sales team continues to be linked to reimburse test and revenue over volume growth. We're also arming the field with robust analytics reporting to support these goals. More recently, we reduced the target list for our sales managers. This change also allows us to foster stronger relationships with our customers and increases touch frequency in the field.

Second, as a result of additional restructuring actions we undertook in January, we dissolve certain sales territories and merged others to further optimize our footprint and focus on the highest-value regions. As a result, we reduced our sales territories from approximately 60 to roughly 55. We are intentionally pursuing a strategy that prioritizes ASP. and revenue growth over volume growth in the short term.

In closing, we've significantly improved many of our key operating and financial indicators for two consecutive quarters. We believe this approach is the best way to reach a meaningful revenue inflection point. With that, let me turn the call over to Kevin for a more detailed financial review.

Kevin Sun - *DermTech Operations Inc - Chief Financial Officer*

Thanks, Brett, and good afternoon, everyone. I'll outline our key financial and operating metrics for the fourth quarter. Then summarize how we're thinking about 2024.

I'll wrap up by recapping our liquidity profile and cash runway estimates. All comparisons are to the prior year period, unless otherwise noted, test revenue was up 38% to $3.7 million, largely due to a higher ASP for the DMT. test revenue was flat sequentially. Billable sample volume declined 11% to approximately 15,580 and was down less than 1% sequentially year over year. And sequential decrease was partly due to prioritizing reimbursed tests ahead of total volume and the overall reduction in the size of our sales force. As previously noted, we also stopped testing samples from pediatric patients and certain Fitzpatrick skin types in early 2023 based on guidance from our lab accrediting organization, which also affected the year-over-year comparison. The sequential decrease was also partly due to seasonality we have previously seen during the year and holiday season. Contract revenue was $0.2 million compared to $0.3 million. The decrease is from the timing of activity related to clinical trial. Progress of our biopharma customers. Total revenue increased 31% to $3.9 million, primarily on higher test revenue. Drilling into our test revenue drivers. First ASP. was up 55% to $238 per sample and up 1% sequentially. The Medicare proportion of billable sample volume hit another all-time record high, increasing sequentially from 27% to 28% in the last three quarters. This proportion has increased by five percentage points and has contributed to the ASP improvement. We're beginning to see consistent payment from Tricare and the VA as well as improving payment from certain other Blues plans we signed last year. The revenue benefit is ramping from the big increase in covered lives. We've achieved but we still need to clear administrative and billing obstacles in some cases before improved payment behavior of some from certain insurance providers.

Net positive prior-period adjustments had a negligible impact on test revenue during the fourth quarter. SP. may fluctuate in the future as payers update their administrative procedures or other requirements for payment, even those payers with consistent reimbursement history.

Second we had approximately 2,200 unique ordering clinicians in the fourth quarter, down 2% sequentially because we're currently focused on building deeper relationships with clinicians rather than creating broad awareness for the DMT., the level of unique ordering clinicians may continue to be flat or even modestly down in the short term. Third, our average quarterly utilization or average number of tests ordered per unique ordering clinician was 7.1 billable samples in the fourth quarter, up from 7.0 in the third quarter and versus 7.2 in the year-ago period.

Turning now to operating expenses. Cost of test revenue was $3.4 million, an increase of 4%, yielding a test gross margin of 7% our quarterly test gross margin was the highest it's been in six quarters. The increase in cost of test revenue was primarily due to higher infrastructure costs related to our new lab sales and marketing expenses were $8.4 million, a 38% decrease, largely due to lower employee-related and marketing expenditures. Research and development expenses were $3.3 million, a 34% decrease, primarily due to lower employee-related and lab supplies costs.

General and administrative expenses were $8.4 million, a 14% decrease, driven by lower employee-related costs, offset by higher infrastructure costs related to our new facility on a full year basis, including the impact from our comprehensive restructuring actions and other efforts to identify cost reductions we expect an approximately $40 million annualized reduction in total operating expenses versus 2022. Total operating expenses for 2024 are currently estimated to be approximately $80 million net loss was $19.1 million, which included $3.2 million of non-cash stock-based compensation expense compared to a net loss of $28.2 million, which included $5.3 million of non-cash stock-based compensation expense. Net loss decreased 32%, while test revenue increased 38%.

Moving now to how we're thinking about 2024 we believe DMT volumes could be flat to modestly down for the first half of 2024 compared to the same period last year, primarily due to our focused unreimbursed test and the impact in the field from our restructuring actions and the change in tactics will continue to emphasize ASP. and revenue growth.

And lastly, a review of our liquidity profile and balance sheet. At year end, we had cash, cash equivalents, restricted cash and marketable securities of $59.3 million. Cash burn is estimated to decline to $55 million to $60 million annually based on the fourth quarter of 2023 run rate, a roughly 40% decrease from our net cash burn in 2022. We believe we have cash runway into the first quarter of 2025, not to exceed 12 months from today's 10 K filing.

In summary, our plan demonstrated sustained results in growing revenue during the second half of 2023, while operating with a leaner organization. Now I'll turn the call back to Bret.

Bret Christensen - *DermTech Inc - President, Chief Executive Officer, Director*

Thanks, Kevin. Before we wrap up and move to Q&A, I'll share a compelling patient story that inspires us as we forge ahead, a patient will see in her dermatologists on a monthly basis for severe acne treatment without any other concerns during our last visit, she mentioned more on our arm that you hadn't noticed before clinician evaluated the mall and was concerned. But because the patient was worried a DMT. was ordered. The test came back positive, indicating the correlation with melanoma. A biopsy of the lesion was then sent to a pathologist who confirmed it was melanoma and the patient was referred to a surgical oncologist. The health care provider is still in shock that this patient may have otherwise walked out of the office. This story much like others, we hear on a regular basis highlights the critical need for precision genomics as cancer is a disease of the genome and the current visual assessment standard is challenging even for expertly trained medical professional the DMT. helps clinicians evaluate higher risk lesions alongside other traditional tools. With that, I'll turn the call back to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Thomas Flaten, Lake Street Capital Markets.

Thomas Flaten - *Lake Street Capital Markets, LLC - Analyst*

Hey, guys, appreciate you taking the questions. Just out of curiosity, with it. I just wanted to clarify, Kevin, you said that you expect volumes in the first half of 2024 to be down relative to the first half of 2023, the Elara contract.

Okay.

So closer to where we were in 3Q and 4Q or a lesser reduction from 17 to high sevens to mid to high seventeens?

Kevin Sun - *DermTech Operations Inc - Chief Financial Officer*

Yes, we're not providing specific guidance right now.

We're happy with the performance in Q4 and again, where our updated strategy to prioritize reimburse volume drove a 55% year over year ASP growth and a 38% year over year test revenue growth.

Q4 was that second quarter of where we've achieved sequential growth in these top-line metrics. I'm sorry, as we said we believe the volumes could be down for the first half because of the impact in the field from the restructuring and the change in tactics, we have about 15 fewer sales territories now than we did in Q1 of 2023. And we do plan to continue to emphasize throughout the organization our focus on driving ASP improvements on but providing any specific guidance right now remains difficult without having a trend for several quarters in payer reimbursement behavior and the sustained effectiveness of our updated commercial tactics.

Thomas Flaten - *Lake Street Capital Markets, LLC - Analyst*

Got it. And with respect to the $40 million reduction in OpEx relative to 2022. Could you help us maybe spread those savings around?

Kevin Sun - *DermTech Operations Inc - Chief Financial Officer*

Is it kind of a pro rata cut across the three OpEx lines or how should we think and it would be fairly, I think, a consistently spread as we saw within the fourth quarter results. So it is all in the up and down the organization where we've made cost saving and efficiency efforts. And so I think as we said previously, looking at the fourth quarter of 2023 is kind of a benchmark going forward.

That's a good kind of jumping off point for where we think expenses and costs will be in the future.

Thomas Flaten - *Lake Street Capital Markets, LLC - Analyst*

And then one final one, if I might was there anything out there, speaking to the the Medicare penetration, was there anything specifically you did tactically to drive that number up? Or was this just kind of a natural evolution of the business where that's starting to get closer to where it should be in the kind of around about 50%?

Bret Christensen - *DermTech Inc - President, Chief Executive Officer, Director*

Yes, Thomas, this is Brett. I'll take that one. If you remember, there's quite a few tactics that we deployed that you'll start in the middle of last year and they evolved throughout the year, but many of those were around the focus for the mix that comes in the door reimbursed tests. And certainly a big portion of that is Medicare. If you remember, we changed comp plans for our field sales personnel to focus on revenue and reimbursed tests versus strictly volume, which was historically how comp was laid out for them. We also provided them with the analytics and targeting tools to help them understand where most of their reimbursement was coming from. And we on top of that, we reduced the number of targets that each rep was calling on, so they can go deeper into each practice at all that has sort of paid dividends in the form of Medicare reimbursement, but also just overall ASP.

Thomas Flaten - *Lake Street Capital Markets, LLC - Analyst*

Fantastic. Appreciate taking the questions.

Operator

(Operator Instructions) Andrew Brackmann, William Blair.

Andrew Brackmann - *William Blair & Company, L.L.C. - Analyst*

Hey, guys. Good afternoon. Thanks for taking the question. And maybe just one on the major commercial payers in the 10 K, I think you call out you believe there's possibility to secure some sort of contract from them over the next 12 to 24 months. Can you maybe just sort of talk about some of the confidence behind sort of putting that timeframe out there or anything which has sort of changed over the last handful of months here?

Bret Christensen - *DermTech Inc - President, Chief Executive Officer, Director*

Yes, Andrew, it's Bret, that we continue to have really good conversations with the national payers. We're happy with where reimbursement ended this past year adding 42 million covered lives and finishing about 45% of all covered lives for DMT. We did, if you remember, three negative policy decisions last year from three of the nationals, we're having good conversations with one but trust to as an opportunity for us when that's published in the next several months to go back to all the national payers and continue those conversations. And as we've said in the past, we're just optimistic because the economics of DMT. are so strong for payers that we know that eventually draft favorable policy and I cover the test.

Andrew Brackmann - *William Blair & Company, L.L.C. - Analyst*

Great.

And then, Brett, you sort of talked about reducing the target lifts for your commercial team and anything analytically that you can share, which sort of shows that the greater frequency and greater touch share leads to either greater utilization of the test or even a movement towards more reimburse test for those providers?

Bret Christensen - *DermTech Inc - President, Chief Executive Officer, Director*

Yes.I think, Andrew, we're still learning a lot from the revised tactics last year. But one thing we know is that you're selling DMT in dermatology requires time and frequency in the field, and we revised the messaging with the salespeople to start with the clinical argument for DMT., making sure that dermatologists understand the clinical utility, the 99.7% negative predictive value that we showed in trust two, and we figure out where we can integrate it into the practice. So it's a non threatening message that gets them to say, look, I there's sometimes I don't want to do a biopsy. And when I don't want to do a biopsy, yes, I would use DMT. And whatever that percent of biopsies is 2025 30%. We work on integrating that into their practice or becomes habit and just part of what they normally do and that takes some time. It takes frequency. It takes a number of sales calls. And so that's why we think fewer targets allows for that to happen quicker.

Andrew Brackmann - *William Blair & Company, L.L.C. - Analyst*

I'll leave it there. Thanks, guys.

Operator

(Operator Instructions) Mark Massaro, BTIG.

Unidentified Participant

Hey, guys. This is Vivian on for Mark. Thanks for taking the question. and thank you for the time and either a health plan wins that haven't turned on. And I think you alluded to some administrative and billing obstacles preventing well, you do have coverage antigens anymore.

Kevin Sun - *DermTech Operations Inc - Chief Financial Officer*

You rarely you could yes, I believe for the most part, most of all of the wins that we had last year have started paying something, but there are certainly still upside potential in improving the payment rate because, again, it's sometimes it's documentation. Sometimes it's specific processes. We have to follow them to allow for better payment with them so that they are improving. But there is still more room for improvement to focus on those efforts, too, improve it as much as we can.

Unidentified Participant

Okay, perfect. Thanks, Kevin. And and what kind of trends in utilization per ordering clinician to call out, and I think we've had it in the past that it takes a certain number of paths that clinicians need to get through to get there. First positive results and really understand the value proposition. And so just anything else to call out there?

Kevin Sun - *DermTech Operations Inc - Chief Financial Officer*

I think as we said before, because we're trying to go deeper right now, the number of unique ordering clinicians in any quarter could be flat or even modestly down. But with that same rationale, we would expect the utilization to increase.

And because, again, if we're going deeper and making sure it's integrated in the practice, as Brett mentioned, making sure that the clinicians understand the clinical value and the best places to use the technology and how to get comfort to their patients with it. We do believe that that should drive increases in utilization on a per doctor basis. And that's where we're focused right now instead of broad marketing and awareness. It's really going deep and trying to get applicants and trying to get them to understand where to use it and integrated into their practice.

Unidentified Participant

Awesome, thanks for taking the question.

Operator

Mason Carrico, Stephens.

Mason Carrico - *Stephens Inc. - Analyst*

Hey, guys. Thanks for the questions. Two quick ones upfront from me here. If that's all right. Maybe on the news of discontinuing the optional add-on assay, could you kind of talk about the cost benefit there from a COGS protests perspective? And second, you guys had previously talked about some ongoing projects to drive down COGS. I think some of those dependent more on on volumes and scale, others were more project related. So could you just walk through where stand on some of those today?

Kevin Sun - *DermTech Operations Inc - Chief Financial Officer*

Hey, Mason. So with Turkey itself, again, what we assessed as part of the Trust to dataset is that there was limited improvement in some of the key statistical measures or performance metrics of the test when it was included. And we also have determined through getting feedback from clinicians who use our tests test that chart didn't really impact clinical decision making too much. So the reason that we decided to simplify the DMT. and stop testing chart was just that to simplify it and um, and based on the patient need and how it's being used in clinical practice as a hum as a benefit to that decision, though, we should get some improvement in COGS from Turkey was a DNA mutation that was run on a separate piece of equipment. And so that was the only use for that equipment. And there was also additional processing time and people needed to process those things. And again, part of the reason we also discontinued it is that we were only able to report out a test result in about a third of the time that was ordered or less. So we haven't quantified yet exactly what that will be because there will certainly be some direct cost savings from not having to use supplies and the labor, but as we're still working through what to do with the equipment. And now we also have fixed costs that are spread to other parts of the processing. So it should provide some savings, but we haven't provided definitive detail on that yet.

And then as relates to the other cost-saving measures, so we'll continue to focus on all sorts of things, whether it's systems improvements, whether it's material cost related to the configurations or different things within the kits, labor, efficiency, automation, these are all things that we'll continue to work on as well as technology improvements. Some of them can go a little bit sooner than others. Some of them take some more work to validate and ensure that it doesn't affect how the test works, but we're committed to continue to improve the COGS profile. And as we saw just in Q4, we had just slightly lower volume, then Q. three, which meant that the fixed portion of the costs were spread over again, a slightly lower base than in Q3, but we're also able to reduce the COGS on a per test basis about 6% in Q4 sequentially. And that's the lowest cost per test that we've had since actually moving into the new laboratory. So we're committed to improving it, and we've already demonstrated some improvements to it, and we'll have more information around trade specifically once we get it fully on the change fully implemented.

Mason Carrico - *Stephens Inc. - Analyst*

Got it. Thanks, Kevin.

Operator

(Operator Instructions) Dan Brennan, Cowen.

Dan Brennan - *Cowen & Co., LLC - Analyst*

Great, thanks. Thanks taking the question. Sorry, I joined a few minutes late, and I just wanted to understand a little bit and you've probably already addressed this but in terms of the outlook for '24, I don't think you're giving much, but I'm just wondering if there's any framework to at least consider from a price volume standpoint, how it think about?

Kevin Sun - *DermTech Operations Inc - Chief Financial Officer*

Yes, we're going to continue to emphasize, you know, throughout the organization, our focus on driving ASP improvements, but providing the specific guidance right now remains difficult without having a trend for several quarters in payer reimbursement behavior and whether or not there's the sustained effectiveness of our updated commercial tactics.

Dan Brennan - *Cowen & Co., LLC - Analyst*

So we're not we're not providing any additional detailed guidance at this point, is it is it fair to think like discrete, Scott, 20 million in revenue for 24 versus the, call it, 15 million this year, like rather than be completely all sides. I mean, is there any framework at all to think about magnitude or it's just impossible at this point?

Kevin Sun - *DermTech Operations Inc - Chief Financial Officer*

It's very challenging and difficult at this point based on the factors we've just said.

But as we said, we'll continue to focus the team on driving those improved ASP improvements to drive revenue improvements, which we are able to demonstrate in Q3 and Q4 with the change in tactics to be able to get some improvements there.

So that's one of the focus will continue to be. But yes, we're not providing detailed guidance right now.

Dan Brennan - *Cowen & Co., LLC - Analyst*

And on the trust to study on, I think you talked about it's really important to engage with payers, like what kind of payers you specifically looking to engage with and any potential time line of like reviewing decision?

Bret Christensen - *DermTech Inc - President, Chief Executive Officer, Director*

Yes, Dan, it's Brett. Yes, trust is going to help us with all outstanding payers that don't have a policy a positive policy yet for DMT. specifically the nationals, we think it's a large cohort, 20,000 patients are highest and negative predictive value that we have to date of 99.7, but all of our publications show over 99%. So it will help with the majority payers and the discussions that we're having to date and we expect that publication probably in the next several months. So it's a really good opportunity for us to put that in front of payers and restart any negative policy decisions, but also continue the ones we're having today.

Dan Brennan - *Cowen & Co., LLC - Analyst*

And just maybe one final one on that. So is that sort of NPV definitely the most important metric to consider what else are the payers look sorry,

Bret Christensen - *DermTech Inc - President, Chief Executive Officer, Director*

yes, since it's a rule-out test and what clinicians are looking to do is just rule out the need for biopsy and further procedures.

The negative predictive value is really the by far the most important factor for us. It's what they point to is a rule-out test, and we're pleased with that result.

Dan Brennan - *Cowen & Co., LLC - Analyst*

Okay, great. Thank you.

Operator

(Operator Instructions) Connor Chamberlain, Craig-Hallum.

Connor Chamberlain - *Craig-Hallum Capital Group LLC - Analyst*

This is Connor on for Alex.

Thanks for taking my questions. Some so you've been working on getting these commercial payers online for years now, can you maybe talk about how DermTech has evolved their approach in talking with these payers over time?

Kevin Sun - *DermTech Operations Inc - Chief Financial Officer*

Hey, Connor, yeah. It's we've been we've been working for awhile to get payers on board. But if you remember, we went public in 2019, had a bit of a of a blackout with COVID, but quickly got back on track with payers adding 42 million covered lives last year, seven of the top 10 Blues. So we're having we're having really good progress these discussions just take time and they take more time with the nationals who tend to drag their feet and do a little bit more analysis so that the discussions are going well. It's on it's impossible to predict when they'll come through. But trust two, again, is a really good opportunity for us to put some strong data in front of these payers, and we're optimistic that will continue to progress throughout the year.

Connor Chamberlain - *Craig-Hallum Capital Group LLC - Analyst*

Great. And then just one more here on with current OpEx pushing about $80 million run rate for '24, and we're still getting minimal gross profit, just how do we make this math work? So we believe we have cash runway into the first quarter of 2025, not exceeding 12 months from today's 10-K filing date. Based on our cash on hand, our most recent cash usage and our future operating projections, we're going to continue to focus on driving ASP improvements to improve revenue and we'll continue to focus on trying to find cost saving better measures and efficiencies wherever we can.

Great.

Thanks for the update.

Operator

I show no further questions at this. This will conclude today's conference call. Thank you for your participation. You may now disconnect.