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OSUR - Q1 2014 OraSure Technologies, Inc. Earnings Conference Call

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PRESENTATION

Operator

Good afternoon, everyone, and welcome to OraSure Technologies' 2014 first-quarter financial results conference call and simultaneous webcast. As a reminder, today's conference is being recorded. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer period. (Operator Instructions)

OraSure Technologies issued a press release at approximately four p.m. Eastern Time today, regarding its 2014 first-quarter financial results and certain other matters. The press release is available on our website at www.orasure.com, or by calling 610-882-1820. If you go to our website, the press release can be found by opening the Investor Relations page and clicking on the link for press releases. This call is also available real time on our website and will be archived there for seven days. Alternatively, you can listen to an archive of this call until midnight, May 14th, 2014, by calling 855-859-2056 for domestic, or 404-537-3406 for international. The access code is 31956599.

With us today are Doug Michels, President and Chief Executive Officer, Ron Spair, Chief Operating Officer and Chief Financial Officer, and Kathy Weber, Senior Vice President and General Manager Consumer Products. Doug and Ron will begin with opening statements, which will be followed with a question-and-answer session.

Before I turn the call over to Doug, you should know that this call may contain certain forward-looking statements, including statements with respect to revenues, expenses, profitability, earnings or loss per share, and other financial performance, product development, performance, shipments and markets, business plans, and regulatory filings and approvals.

Actual results could be significantly different. Factors that could affect results are discussed more fully in the Company's SEC filings, including its registration statement, its annual report on form 10-K for the year ended December 31st, 2013, its quarterly reports on form 10-Q, and its other SEC filings.

Although forward-looking statements held to provide complete information about future prospects, listeners should keep in mind that forward-looking statements may not be reliable. The Company undertakes no obligation to update any forward-looking statements to reflect events or circumstances after this call.

With that, I would like to turn the call over to Doug Michels.



Doug Michels - *OraSure Technologies, Inc. - President, CEO*

Great. Thanks, Rena, and good afternoon, everyone, and welcome to our call.

Earlier today, we issued a press release in which we announced our first-quarter financial results for 2014. Consolidated net revenues for the quarter were \$23.5 million, an 11% improvement from the first quarter of 2013. The biggest contributor to this growth was our molecular collection systems business. That segment continues to deliver exceptional results, with net quarterly revenues of \$5.8 million, a 46% increase over 2013.

Strong growth in our HCV business, higher sales of our OraQuick In-Home HIV test, and higher cryosurgical systems revenues also contributed to revenue growth in the quarter.

We're very pleased with our first-quarter results, and we expect continued strong performance throughout the remainder of 2014.

Ron will begin with a financial review, and later in the call I will provide some business updates. In particular, I will describe the changes we are making to the promotional strategy for our OraQuick In-Home HIV test in order to improve the financial performance of this product.

So with that, let me turn the call over to Ron to review our first-quarter results and to update our guidance. Ron.

Ron Spair - *OraSure Technologies, Inc. - COO, CFO*

Okay. Thanks, Doug, and good afternoon, everyone. Our first quarter 2014 consolidated net revenues were \$23.5 million, compared to \$21.2 million reported in 2013. Our consolidated product revenues increased 12% as a result of higher sales of our molecular collection systems, OraQuick HCV, OraQuick In-Home HIV, and our cryosurgical systems products.

These increases were partially offset by lower sales of our OraQuick professional HIV product in the domestic market and our substance abuse and insurance risk assessment products.

Our molecular collection systems revenues, primarily representing sales of the Oragene product line, increased to \$5.8 million in the first quarter of 2014, compared to \$3.9 million in 2013. This 46% increase was the result of higher sales in both the commercial and academic markets.

Our overall infectious disease testing revenues increased 4% to \$11.1 million in the first quarter of 2014, compared to \$10.7 million in the first quarter of 2013. Aggregate sales of our OraQuick HCV professional product in both the domestic and international markets increased 133%. International sales of our HCV test in the first quarter of 2014, increased to \$896,000 from \$240,000 in the same period last year, primarily due to sales in support of a significant testing program with an international NGO.

Higher demand in the domestic market among new and existing customers contributed to the increase in sales of our HCV test in Q1, to \$663,000 from \$428,000 in the prior year.

During the current quarter, net sales of our OraQuick In-Home HIV test were \$2 million, compared to \$1.4 million in the first quarter of 2013. Net revenues for these periods were not recorded using the same revenue recognition policy and are not readily comparable.

Due to our change in policy beginning in December 2013, revenues in the current quarter were recognized upon shipment to the distribution channels, while revenues in the first quarter of 2013, were recognized upon consummation of a sale to the end user. To better evaluate the performance of this product as compared to the year-ago period, we can look at the number of units purchased by consumers.

So based on available point-of-sale data, unit consumption increased by approximately 22% in the first quarter due to an improvement in consumer awareness. Net sales of this product in the 2014 and 2013 quarterly periods also included approximately \$183,000 and \$128,000, respectively, of direct sales to public health customers.

Domestic sales of our professional HIV product decreased to \$6.6 million in the first quarter of 2014, from \$7.7 million in the first quarter of 2013. This decrease was primarily caused by a delay in purchasing, resulting from a delay in the release of available funding by the federal government to public health jurisdictions. This issue and its impact should be resolved over the next few quarters.

Our first quarter 2014 cryosurgical revenues increased 29% to \$4 million from \$3.1 million in the first quarter of 2013, primarily as a result of higher sales of our professional product in the domestic marketplace and increased OTC sales in Europe.

Sales of Histofreezer to physician offices in the United States increased to \$1.5 million in the first quarter of 2014, from \$891,000 in the first quarter of 2013, as a result of lower sales in the first quarter of last year, as distributor purchases were concentrated in the fourth quarter of 2012, in advance of our January 2013 price increase.

Our OTC sales increased to \$2.1 million in the first quarter of 2014, from \$1.8 million in the first quarter of 2013 due to higher sales to our European distributor as a result of the launch of our product into new market segments.

Substance abuse testing revenues decreased to \$1.8 million in the first quarter of 2014, from \$2.2 million, largely due to lower international sales of our Intercept product, resulting from the discontinuance of purchases by our UK distributor who began selling its own competing product in 2012.

So turning to our gross margin, our gross margin for the quarter ended March 31st, 2014, was 59%, compared to 57% reported for the quarter ended March 31, 2013. The current quarter margin benefited primarily from improved overhead absorption as compared to the first quarter of last year, as well as an improvement in product mix driven largely by the increase in DNA Genotek sales.

Turning to operating expenses, our consolidated operating expenses for the first quarter of 2014, decreased to \$19.5 million during the first quarter, compared to \$22.6 million in the first quarter of last year. This decrease was primarily due to lower advertising and promotional spending related to our OraQuick In-Home HIV test, lower clinical trial costs, and decreased R&D staffing and supply expense.

These decreases were partially offset by an increase in G&A expense due to higher consulting costs. Our advertising and promotional expenses for our OTC HIV test were \$4.6 million in the first quarter of 2014, compared to \$6.9 million spent in the first quarter last year.

From a bottom-line perspective, we reported a net loss of \$5.6 million, or \$0.10 per share, for the first quarter of 2014, compared to a net loss of \$10.2 million, or \$0.18 per share, for the same period of 2013.

So turning briefly to our balance sheet and cash flow, our cash balance at March 31, 2014, was \$84.2 million, compared to \$93.2 million at December 31, 2013. Cash used in operating activities in the first quarter of 2014 and 2013, was approximately \$7.7 million.

Turning briefly to guidance for the second quarter of 2014, we're now projecting consolidated net revenues of approximately \$25.2 million to \$25.7 million and a consolidated net loss per share of approximately \$0.09 to \$0.10 for the quarter.

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

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

Thank you, Ron. And let me start with our OraQuick HCV business. As Ron explained, this part of the business generated significant growth in the first quarter, largely reflecting the ongoing positive trends affecting HCV.

Our aggregate estimated customer base increased as we added approximately 80 new customers during the quarter. On a worldwide basis, 17% of our revenues came from new customers. Our business is growing, and we see a good mix of sales from new and existing customers on a global basis.



On the international front, a significant contributor to our growth is the large international NGO, which we've mentioned on prior calls, which has placed several large orders. I'm happy to report that this customer has indicated its intent to continue purchasing at comparable levels throughout 2014, and we expect this relationship will continue into next year.

As discussed on prior calls, there continue to be developments that we expect will positively affect our HCV business going forward. In particular, there have been several recent studies that confirm the value of our rapid hepatitis C test. A recent study at Johns Hopkins, which was reported at the Conference on Retroviruses and Opportunistic Infections in March, tested over 1,300 patients from a medically underserved community with our product.

A CDC-funded outreach program by the AIDS Resource Center of Wisconsin used the OraQuick HCV to test over 1,000 patients. And an HCV testing initiative at the Wisconsin Division of Public Health, reported in an MMWR issued by the CDC in April, tested over 1,200 individuals with our product.

Each of these studies reported very high prevalence within their test groups and, because a rapid test was used, 100% of the individuals who tested positive received their results and were offered additional care. These studies each further confirm the important public health benefits that result when a rapid testing model is used.

As previously noted, late last year the State of New York passed a law requiring that doctors offer hepatitis C testing as a routine part of healthcare provided to baby boomers. This law went into effect on January 1st this year, and seems to have started a trend. There are now at least 10 states with HCV testing legislation currently pending.

So looking forward, we are extremely optimistic about this part of the business. We expect growth to continue in both the domestic and international markets. As discussed on prior calls, we've engaged in various discussions to secure a new marketing collaboration for our HCV test. Although we've not finalized anything yet, we have made good progress, and I hope to have something to share with you in the near future.

This is an exciting time for our HCV testing business, and we are enthusiastic not only for the prospects for OraSure, but for the significant benefits we can provide to the large number of individuals who are afflicted with hepatitis C.

As Ron stated, net sales of our OraQuick In-Home HIV test increased to \$2 million for the first quarter and included almost \$200,000 in sales to public health organizations. During this period, average weekly out-sales by the major retail chains increased 6% in January, 9% in February and 8% in March, when compared to the immediately preceding month.

We believe this growth is attributable to the continued execution of our "Life As We Know It" campaign, which we've mentioned in prior calls.

During the first quarter, we launched our collaboration with the BET TV Network program "Being Mary Jane," featuring a customized, co-branded TV message, digital advertising, and an interactive event. We also continued our work with LOGO TV Network and Essence magazine and conducted several press events recognizing National Black HIV/AIDS Awareness Day in February and a series of interactive panel events with several celebrity spokespeople.

We launched a new 15-second TV spot featuring Bravo Network celebrity Demetria Lucas, and participated in several major gay pride events. We believe these programs have contributed to the sales increases during the first quarter.

The retail environment remains challenging, but each quarter we continue to make progress against our key goals of ensuring easy access and appropriate in-stock levels at retail. We have seen positive movement in retail shelf inventory, with a 7% increase since December of last year. More importantly, we've made progress in right-sizing the inventory at many stores.

High-performing stores have increased average shelf inventory levels per store by 24% with lower- movement stores decreasing their average shelf inventory levels by 13%. In March, we shipped out our first retail display units, including 1,800 displays to Walgreens. These displays will increase the product visibility at the store level and help ensure adequate inventory in higher volume locations.



Since the start of this program, stores with displays have experienced a growth rate 2 1/2 times that of the stores without displays.

Despite these efforts and improvement in sales levels, the OraQuick In-Home HIV test is not generating the returns necessary to justify our continued spending on promotional activities at current levels. Consequently, in the second quarter we began to transition to a new promotional strategy, focused on more cost-effective methods of building awareness and stimulating consumer adoption.

During the second quarter, we will continue to invest in media, particularly in the digital space, albeit at levels lower than in previous quarters, as we wind down our LOGO, BET and Essence collaborations. By the end of the second quarter, we will be largely transitioned out of broad-based consumer advertising.

Going forward, you can expect to see a focus in trade support and retail activities leveraging the HIV outreach programs of our leading retailers, continued partnerships with public health and advocacy organizations and reliance on new, efficient distribution and promotion methods in the digital space. We will also continue tactical executions with retailers and involvement in key moments of momentum opportunities such as National HIV Testing Days.

As a result of these changes, our promotional costs will drop from the \$4.6 million which was spent during the first quarter, to roughly \$3.2 million in the second quarter, with further reductions planned for the second half of this year, resulting in a quarterly promotional spend of less than \$1 million in quarters three and quarters four.

While this approach is expected to drive towards greater profitability for the brand and the Company, we may see declines in revenue during the second and third quarters as we transition out of broad-based advertising and implement these tactical retail-level promotions. Once this transition's complete, we expect to resume sales growth, albeit at lower rates than previously seen.

Again, our goal is to continue to build this brand, but to do so in a way that contributes positively to the profitability of the Company.

In short, our OraQuick In-Home HIV test business remains important and it warrants continued investment. We still believe in the business potential of the product, but we recognize that it's going to take time to build awareness and stimulate further customer acceptance.

Going forward, we will better align our spending with revenues as we drive this product line toward profitability. We believe this change is in the best interest of both the Company and its stockholders.

On the international front, we continue to evaluate some of the more attractive opportunities. As you may know, the United Kingdom recently repealed a law that prohibited in-home HIV testing, thereby opening the door for a product like our in-home HIV test.

We are actively pursuing CE mark approval while we continue to look more broadly at various European markets. Our U.S. experience regarding the challenges of building this new brand will be factored into our commercial assessments of new international markets. And as our plans evolve, we will certainly keep you posted.

A final area I want to address is our molecular collection systems business. With first quarter revenues of \$5.8 million, DNA Genotek recorded its second highest quarterly revenue total ever and continues the strong quarterly growth reported throughout 2013. This performance is a testament to the value proposition underlying the Company's Oragene and ORAcollect products.

During the first quarter, DNA Genotek's revenues from commercial customers were 80% higher than the first quarter of 2013. Revenues from commercial customers constituted 53% of DNA Genotek's revenues for the current quarter.

Academic revenues for the first quarter were also strong, growing almost 30% over the comparable period in 2013. This growth was driven by shipments to the EU and other rest of the world countries. During the first quarter, we also signed an agreement for a large-scale research study in Australia, and the revenue for that opportunity will be spread over several future quarterly periods.

In past calls, we've also mentioned DNA Genotek's ongoing efforts to expand production. I'm pleased to report that our new manufacturing line is now very close to being fully operational. We expect to begin production within the next week or so. And when operational, this new line will triple our capacity to produce our Oragene product and will continue to support the growth in this important business segment.

So in conclusion, 2014 has started out on a very strong note. Our business is performing well, and the Company's overall financial performance is expected to improve as the year continues. One important factor, of course, contributing to this performance will be our new retail-oriented promotional strategy for the OraQuick In-Home HIV test. This change should help drive a more cost-effective contribution from this product line.

And with that, I'll now open the floor to your questions. Operator, if you'd please proceed.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Jeff Frelick, Canaccord.

Jeff Frelick - Canaccord - Analyst

Maybe a question for Ron first. Ron, on the step-down in spending for HIV OTC, the profitability, EPS profitability, does that move up? Should we expect to see that sooner? And can you kind of give us a sense of maybe timing when that appears?

Ron Spair - OraSure Technologies, Inc. - COO, CFO

Right. So as Doug indicated, our expectations are moving from the \$4.6 million worth of spend in Q1 to a \$3.2 million spend in Q2. And then as we transition into the second half of the year, our quarterly HIV OTC spend will be in the neighborhood of approximately a million dollars or so, little less than that.

And so as we transition away from that level of spending that we incurred historically, we're obviously moving more towards profitability here. And with the HCV business continuing to grow and expectations for DNA Genotek and other parts of the business contributing, it's all moving towards getting us to where we all want to be towards profitability.

Jeff Frelick - Canaccord - Analyst

Okay. On the HCV side, Doug, you mentioned about 80 new customers added. Were those predominantly public health or some of those in the primary care setting? Any color there you can share?

Doug Michels - OraSure Technologies, Inc. - President, CEO

We saw growth really across all of the segments when you look quarter on quarter. Public health overall was up more than 30%. The physician office group grew substantially and that's good to see. And international was up substantially as well. So really pretty good growth across all the different segments.

Jeff Frelick - Canaccord - Analyst

And then how about reorder rates for HCV customers? Where does that stand?

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

It was strong. I think we mentioned in the prepared remarks order from new customers represented somewhere in the 17% range for the quarter. So the rest of that was all reorders from existing customers.

Jeff Frelick - *Canaccord - Analyst*

Okay, great. Thanks. I'll jump back in the queue.

Operator

Brandon Couillard, Jefferies.

Unidentified Participant

This is Kate in for Brandon. Can we just go back to the DNAG business? And maybe could you talk about some of the growth drivers behind the commercial portion of the business? And specifically, are there any bulk orders that you could call out?

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

Well, so the commercial revenues were up 83% for the quarter, so again very strong. And commercial revenues once again represented the majority of our revenues for the quarter, about 53% of total revs.

Commercial revenues were also well diversified across a variety of different customers, pharmacogenomic applications, some bone marrow donor registry business increased in the quarter, contribution from organizations that are providing services in pain management, in psychiatry. So really, a well-diversified product mix out of the commercial segment.

We also had a contribution from 23andMe in the quarter, and we expect more to come through the remainder of the year. Although, once again, I want to caution that we expect a decreased contribution to 2014 revenues from 23andMe until they resolve some of the issues associated with the 483 that they received last year.

With that understanding, though, despite reduced contribution from 23andMe, in the year, we expect to see nice growth from DNA Genotek for the remainder of 2014.

Unidentified Participant

Okay, great. Thanks. And could you [comment on] a timeline for a CE approval for the OTC products internationally? And any comments on a go-to market [size there]? Thanks.

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

I'll let Kathy handle that question.



Kathy Weber - *OraSure Technologies, Inc. - SVP, GM Consumer Products*

Yes. It's difficult to comment on the timeline for CE market approval, because there are so many factors that go into that - review of the data, the regulatory process. So as we said in the prepared remarks, we're actively pursuing CE market approval and we're also investigating the commercial possibilities and factoring in all the learning about the challenges in the US marketplace, building awareness, driving new product behavior in terms of understanding what the commercial opportunity is there.

So we're in the midst of all those activities right now. It's just a little premature to definitively talk timing.

Unidentified Participant

Okay, great. Thank you.

Operator

Thank you. Shaun Rodriguez, Cowen and Company.

Shaun Rodriguez - *Cowen & Co. - Analyst*

Thanks for taking the question. So on DNA Genotek, you talked about a few different dynamics there and touched on 23andMe, which was one of my questions. But I guess shaking it all out, on last quarter's call, or maybe it was back when 23andMe issues got announced, you were talking about Genotek as a segment that could see modest growth for the year.

So I guess my question is, after the Q1 results, is that how you would still characterize your expectations on a full-year basis or are they increased now?

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

Yes, I think we have to be careful not to get out in front of our skis on this one, right. So we had real strong growth in the fourth quarter of 2013, we're following that up with, again, real good growth in Q1 here.

Going back to revenues last year, 23andMe began to kick in in the second quarter and was a strong contributor to revenues in Q3 and Q4. So our comps now, going forward, are going to be a little more challenging, with 23andMe in the 2013 revenues.

So I think we just have to be careful of that. We still expect growth from DNA Genotek. Obviously, we're off to a real good start. I think we're going to continue to see improvement in the academic business, which is a real positive, and first quarter was terrific, with revenues up 30%. I think academic revenues actually were higher in first quarter of 2014, than they'd been since 2012. They were certainly higher than any quarter that we had in 2013.

So Company continues to make good progress in bringing on new customers in both academic and the commercial space. Company continues to make good progress on their development programs with both the blood products, the sputum product, and the microbio project. So we continue to be very pleased with how the team's performing up there, and we expect good contributions for the rest of the year, and then, of course, into 2015.



Shaun Rodriguez - Cowen & Co. - Analyst

Okay, thanks. And then, Ron, on Q2 guidance, does gross margin decline or does spend pick up anywhere? I guess what I'm getting at is, when I have sort of a mid-range revenue number in there and I bring the OTC spending down, I'm coming out at EPS numbers that are higher than where you guys are.

So is there anything in the mix or anything in spend outside of that line that's changing sequentially that would get us there?

Ron Spair - OraSure Technologies, Inc. - COO, CFO

Yes. So I think we'll see a little bit of an uptick in some of the R&D expenditures in the quarter, Shaun, that could contribute to that, yes.

Shaun Rodriguez - Cowen & Co. - Analyst

Okay. Sorry, I'm jumping around. But did weather have any notable impact on just the core HIV or HCV OraQuick businesses in the quarter?

Doug Michels - OraSure Technologies, Inc. - President, CEO

We believe it did. And I think you're hitting on the major parts of our business that would be affected by weather in the public health sector, in particular, where different jurisdictions are going out into the community, they're relying on gaining access to people in the different clinics and points of service.

And you think about some of our larger jurisdictions like New York, DC, Philadelphia, Atlanta, cities and communities that were, in essence, shut down for weeks at a time. We estimated it probably had a dampening effect maybe as high as 5% to 10%.

Be careful, though, also, to understand the shortfall in the public health, HIV business was due to a funding change that the CDC made to their grantees in 2014. And what happened there, and this is unfortunate, but we should catch up on this through the remainder of the year, generally, when the CDC gives a grant notification to a jurisdiction that they're being funded for a certain program, almost simultaneously with that grant notification, they transfer the funds into that jurisdiction's account.

In March of this year, they had a disconnect in that process. And while grantees were notified of their award in, I believe it was around March 11th, many of those grantees didn't actually get their funding until April. And it caused a real gap in terms of a number of jurisdictions' ability to purchase product from us.

Actually, a number of them actually ran out of tests and were out of the testing business for some time. Obviously, those jurisdictions received their funding in April, and they'll be able to catch up. And we expect that that catch up will come back to normal through the remainder of 2014.

But that explains the vast majority of that first-quarter shortfall in the professional HIV business, along with some weather impact that you mentioned.

Shaun Rodriguez - Cowen & Co. - Analyst

Okay. And the last one, if I could, I guess I have to ask the question, although I think I've run out of creative ways to ask it. But on the HCV partnership front, can you give us any more color on those discussions? You said you're still hopeful, and I think that's similar language that you've used in the past. But are we any closer? Is there any other color that you can provide on that? Thank you.



Doug Michels - *OraSure Technologies, Inc. - President, CEO*

I tried to make it even a little more, little more hopeful than I have in the past and highlighted that I think we made some real good progress, so. And, hopefully, we'll have more to share on that in the near future.

Shaun Rodriguez - *Cowen & Co. - Analyst*

Thank you.

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

You're welcome.

Operator

(Operator Instructions) Nicholas Jansen, Raymond James.

Nicholas Jansen - *Raymond James - Analyst*

A couple quick ones for me. In terms of the domestic HCV performance, I would have thought that given the new launches and therapies, you might have been up sequentially. So I'm just trying to get a sense of the timing of orders. Or how should we think about the domestic HCV performance throughout the balance of the year, maybe even what's included and kind of embedded into your 2Q outlook?

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

Yes. I think the way to look at that, Nick, is in Q4 we saw some year-end spending, some extra money that the different jurisdictions had on hand, and that's where we saw the major gap Q4 to Q1 here. Our expectation is that we're going to see sequentially continued growth quarter on quarter through the remainder of 2014, and we expect to see a real strong growth year in hepatitis C across each of the different market segments.

Nicholas Jansen - *Raymond James - Analyst*

Okay. That's helpful. And then kind of looking at the balance sheet, \$82 million, \$83 million of cash. I know you guys have been active on the M&A front before. Just wanted to get your thoughts on what areas of focus are you looking there? Something accretive? Something margin accretive, revenue accretive growth? Just trying to get a sense of how you're viewing the M&A landscape.

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

Yes, thanks. Thanks, Nick. We are looking at opportunities that would be revenue-generating and are at or near being accretive to the bottom line. So that's generally our view towards M&A. We are not necessarily interested in taking on a lengthy development project, but rather a opportunity that is commercialized or very near commercialization that we can take advantage of.

Nicholas Jansen - *Raymond James - Analyst*

Okay. And then last one for me in terms of HIV OTC, the decision to kind of cut back on spend, how do we think about the margin profile of that business as we look to our models in terms of kind of gross margin, the puts and takes for the next couple quarters and into next year? There's

obviously a lot of moving parts with HCV and DNAG being higher gross margin businesses. I believe OTC was a lower gross margin business. So just trying to get a better sense of the puts and takes.

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

Yes. So I think the gross margins on the product itself won't necessarily be affected. We may do a little bit more trade spending, as Kathy indicated. The product gross margin and the production cost is going to be the same. Some of those trade spends, though, will be deductive against our revenues, which should drive down the gross margin from that product line a little bit, but not a significant amount.

And then, as Kathy had indicated, expectations are that over time that revenue will begin to grow again. And, obviously, the spend levels will be much more muted when compared to what we have done over the last several quarters, which will have a much better profile economically for that product line.

Nicholas Jansen - *Raymond James - Analyst*

Thanks, guys. Nice quarter.

Ron Spair - *OraSure Technologies, Inc. - COO, CFO*

Good. Thanks.

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

Thanks, Nick.

Operator

Eric Criscuolo, Mizuho. You may begin.

Eric Criscuolo - *Mizuho - Analyst*

Just filling in for Peter Lawson this evening. I guess on the new manufacturing lines that are coming up online, was there any capacity constraints this quarter that could have impacted sales for the molecular collection business?

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

No, there were not.

Eric Criscuolo - *Mizuho - Analyst*

Okay, great. And then on the funding for the CDC, do those public health labs, do they typically buy in the March months or is it -- like do they wait for that funding to come in? I was just kind of curious because it seemed like it was delayed at the very end of the month, at the very end of the quarter. So I just was kind of curious how their purchasing patterns kind of typically go.

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

They are sporadic and they do follow the funding, believe it or not. And they generally purchase in large quantities, which is an important distinction versus, let's say a hospital account or something like that. So they will buy a quarter, six months, or sometimes some jurisdictions will buy nine months worth of product at a time.

And so that's why these kinds of mismatches can have an impact on the business. Now, the funding's out right now, and so we don't expect this to be an issue on a go-forward basis. And for those jurisdictions that work without tests for some period of time, their challenge is to now increase their recruiting efforts and their deployment efforts so that they can make up for those missed testing events within the communities in which they're serving. And that'll take place over the next weeks and months.

Eric Criscuolo - *Mizuho - Analyst*

Got it. Great. Thanks for that color there. And then just lastly, the cuts that you're going to make for the OTC HIV sales and marketing campaign, is that money going to get plowed back into R&D or anything like that or is it substantially going to kind of fall to the bottom line?

Ron Spair - *OraSure Technologies, Inc. - COO, CFO*

I mean, the cuts of that magnitude aren't -- they will not be repurposed within the operating expense category. That said, we do, as I mentioned before, expect to spend a little bit more in the R&D area in the second quarter here, and that is likely to continue, but certainly not at the magnitude of the cuts that are anticipated to be made in the HIV OTC program.

Eric Criscuolo - *Mizuho - Analyst*

Great. Thanks a lot.

Operator

Thank you. That brings to an end the Q&A session of today's call. I will now turn the call over to Doug Michels for closing remarks.

Doug Michels - *OraSure Technologies, Inc. - President, CEO*

Okay. I just want to thank everybody for joining us on the call this afternoon and this evening, and we look forward to getting together again in a few months and talking about our results from the second quarter. Have a great afternoon and evening, everyone. Thanks again.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation, and have a wonderful day.



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