

HealthEquity, Inc.(HGY)

\$73.25 (As of 01/09/20)

Price Target (6-12 Months): **\$84.00**

Long Term: 6-12 Months

Zacks Recommendation:

Outperform

(Since: 12/09/19)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

1-Strong Buy

Zacks Style Scores:

VGM:F

Value: F

Growth: D

Momentum: F

Summary

HealthEquity saw a solid third quarter of fiscal 2020. Additionally, the company raised its fiscal 2020 guidance. Strong growth in Service and Custodial segments buoys optimism. Solid growth in HSAs and custodial assets bolstered the company's top-line performance. Currently, HealthEquity is the third-largest HSA custodian by market share. In addition to HSA, the company offers health reimbursement arrangement and health flexible spending account to regional employers. The stock outperformed the industry in a year. However, a significant drop in operating and gross margin raises concern. In fact, operating income plunged in the quarter. The company also faces stiff competition in the Medical Services market. HealthEquity is required to comply with the strict treasury regulations formulated by the Internal Revenue Service.

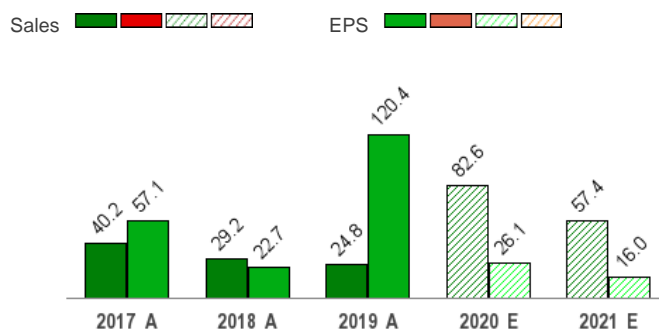
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$85.07 - \$50.87
20 Day Average Volume (sh)	682,860
Market Cap	\$5.2 B
YTD Price Change	-1.1%
Beta	1.51
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Medical Services
Zacks Industry Rank	Top 33% (85 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	113.6%
Last Sales Surprise	3.3%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	03/16/2020
Earnings ESP	0.0%
P/E TTM	45.8
P/E F1	48.8
PEG F1	2.0
P/S TTM	12.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	204 E	201 E	205 E	218 E	825 E
2020	87 A	87 A	157 A	193 E	524 E
2019	70 A	71 A	71 A	76 A	287 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.45 E	\$0.47 E	\$0.45 E	\$0.41 E	\$1.74 E
2020	\$0.41 A	\$0.45 A	\$0.47 A	\$0.18 E	\$1.50 E
2019	\$0.31 A	\$0.34 A	\$0.28 A	\$0.27 A	\$1.19 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/09/2020. The reports text is as of 01/10/2020.

Overview

Headquartered in Draper, UT, HealthEquity provides integrated solutions for health-care account management, health reimbursement arrangement and flexible spending accounts for health plans, insurance companies and third-party administrators in the United States.

HealthEquity's flagship health savings account or HSA is a financial account through which consumers spend and save for the long term for healthcare on a tax-advantaged basis. This has provided the company with a competitive edge in the MedTech industry. Other than HSAs, the company offers Healthcare saving and spending platform, Investment platform and advisory services and Reimbursement arrangements.

In addition, HealthEquity offers health reimbursement and flexible spending arrangements solutions; Employee Retirement Income Security Act's plan administration and investment services.

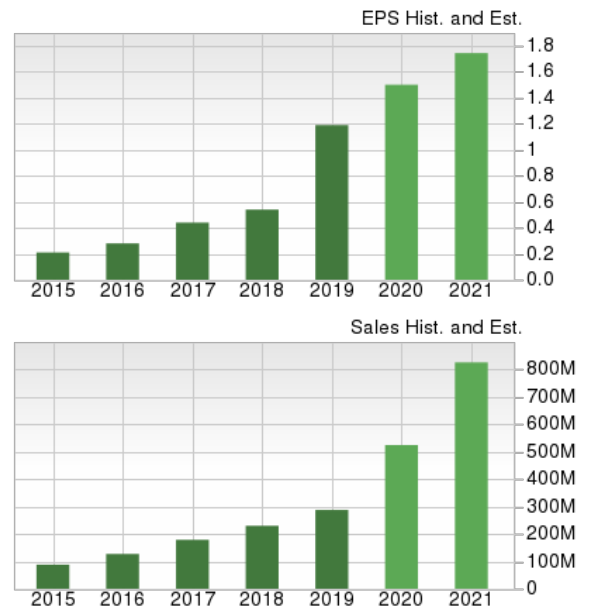
The company operates through three revenue segments:

- Service revenues
- Custodial revenues
- Interchange revenues

FY19 at a Glance

In fiscal 2019 (ended January 31, 2019), HealthEquity reported revenues of \$287.2 million, up 25% year over year. The top line also outpaced the Zacks Consensus Estimate of \$285.9 million. The company reported adjusted net income of \$1.19 per share, up 75% year over year. The figure also surpassed the Zacks Consensus Estimate of \$1.1.

While Service revenues accounted for 40% of net revenues, Custodial revenues contributed 38%. Meanwhile, Interchange revenues accounted for 22% of net revenues.



Reasons To Buy:

- ▲ **Shares Up:** Over the past year, shares of HealthEquity have gained 31.9% against the industry's 9.9% decline. Meanwhile, the S&P 500 index rallied 28%.

HealthEquity saw a strong fiscal third-quarter show, driven by solid HSA member growth. A raised view for fiscal 2020 buoys optimism in the stock.

- ▲ **Health Savings Account (HSA):** HealthEquity is an Internal Revenue Service approved non-bank custodian of HSA, which is a medical savings account available to taxpayers in the United States who are enrolled in a high-deductible health plan (HDHP). The funds contributed to an account are not subject to federal income tax at the time of deposit. Addition to HSA, HealthEquity now offers FSA and HRA administration to regional employers.

As of Oct 31, 2019, the total number of Health Savings Accounts for which HealthEquity served as a non-bank custodian (HSA members), was 5 million, up 37% year over year.

Additionally, total Active HSA members were 4.1 million, up 38% year over year.

- ▲ **Guidance Solid:** Buoyed by a solid fiscal third quarter, HealthEquity raised its fiscal 2020 guidance.

Notably, the company now expects revenues between \$520 million and \$526 million, much higher than the earlier projected range of \$341-\$347 million.

Adjusted net income is projected between \$101 million and \$105 million, much above the earlier stated range of \$76-\$80 million.

Adjusted EPS for fiscal 2020 is expected within \$1.46-\$1.52, compared to \$1.10-\$1.16 issued earlier.

- ▲ **Unique Investment Platform:** It is encouraging to note that in addition to HSAs, HealthEquity offers a mutual fund investment platform and an online-only automated investment advisory service. The advisory service is delivered through a web-based tool, Advisor TM, which is offered and managed by HealthEquity Advisors, LLC. Its members pay huge fees, including all trading commissions and other expenses associated with transactions made through these online tools, for availing the above-mentioned services. Consequently, the company's operating profitability gets a boost.

There are three levels of service offered to investors. However, regardless of the level of service selected, members are responsible for the expenses payable.

- ▲ **Leadership Position:** HealthEquity clinched the top position in the HSA industry through its first-mover advantage, focus on innovation and differentiated capabilities.

The company's market share (measured by custodial assets) has literally tripled from 4% in December 2010 to 13% in December 2018, as noted by the 2018 Devenir HSA Research Report. Currently, HealthEquity is the third largest HSA custodian by market share.

According to the 2019 Midyear Devenir HSA Research Report, Devenir estimates that the HSA market will reach \$88 billion in HSA assets held over by 30 million accounts by the end of 2021.

- ▲ **Unique Suite of Advisory Services:** HealthEquity's automated investment advisory service are delivered through a web-based tool, AdvisorTM, which is offered and managed by HealthEquity Advisors, LLC. Notably, it is the company's SEC registered investment advisor subsidiary. Apart from this, HealthEquity offers 401(K) solution that can reduce the cost, risk and work of managing a retirement plan. In the third quarter of fiscal 2019, management at HealthEquity confirmed that it is doing an excellent job in selling a product in the retirement space and is also optimistic about it.

HealthEquity offers three levels of service to investors — Self-driven, GPS and Auto-pilot. For Self-driven services AdvisorTM provides a mutual fund investment platform to invest HSA balances. For GPS, AdvisorTM provides guidance and advice, but the member makes the final investment decisions and implements portfolio allocation and investment advice through the HealthEquity platform. For Auto-pilot, AdvisorTM manages the account and implements portfolio allocation as well as investment advice automatically for the member.

By the end of fiscal 2020, the company expects to add other administrative and retirement services for regional employers.

Solid HSA member growth is likely to boost HealthEquity's top line. The company now offers FSA and HRA administration to regional employers.

Risks

- **Margins Fail to Impress:** In the fiscal third quarter, HealthEquity's gross margin was 61.1% of net revenues, down 390 bps year over year.

Operating income in the fiscal third quarter was \$9.9 million, down 47.7% year over year. Operating margin totaled 6.3% in the quarter, significantly down from the year-ago quarter's 26.9%.

- **Cutthroat Competition in the Medical Services Space:** HealthEquity faces stiff competition in the Medical Services markets. The company's direct competitors are HSA custodians that include state or federally chartered banks, such as Webster Bank and Optum Bank along with non-bank custodians approved by the U.S. Treasury, such as Payflex Systems USA, Inc. In the United States, the current top HSA custodians are Alliant Credit Union, Bank of America, BenefitWallet, HealthEquity, HealthSavings Administrators, HSA Bank, Optum Bank, SelectAccount, The HSA Authority and UMB Bank.
- **Data-security Issues:** HealthEquity deals with high level of sensitive personal data and information. Any form of security breaches might result in loss of sensitive information, theft or loss of actual funds, litigation, indemnity obligations to the customers. Notably, the company's online platform is hosted from two data centers that are located in Draper, UT and Austin, TX.

Per management, HealthEquity incurred significant costs to protect against security breaches in the fourth quarter of fiscal 2019. A similar trend in the coming quarters might keep its margins under pressure. In fact, there are high chances for the company to incur significant additional costs in the future to address problems caused by any actual or perceived security breaches.

- **Stiff Treasury Regulations:** As a non-bank custodian, HealthEquity is required to comply with Treasury Regulations Section 1.408-2(e) formulated by the IRS. The stiff regulatory environment has been a major dampener for HealthEquity. Notably, any failure to comply with the regulations adversely affect HealthEquity's ability to maintain current custodial accounts.
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Last Earnings Report

HealthEquity Earnings & Revenues Beat Estimates in Q3

HealthEquity reported adjusted earnings per share of 47 cents in third-quarter fiscal 2020, which surpassed the Zacks Consensus Estimate of 22 cents. The bottom line also improved a significant 51.6% on a year-over-year basis.

Revenues of this company amounted to \$157.1 million, which skyrocketed 122.9% year over year and also outpaced the Zacks Consensus Estimate of \$152.1 million.

Quarter Ending **10/2019**

Report Date	Dec 03, 2019
Sales Surprise	3.29%
EPS Surprise	113.64%
Quarterly EPS	0.47
Annual EPS (TTM)	1.60

HSA Member Detail

As of Oct 31, 2019, the total number of Health Savings Accounts (HSA), for which HealthEquity served as a non-bank custodian (HSA members), was 5 million, up 37% year over year.

Additionally, total Active HSA members were 4.1 million, up 38% year over year.

Total Custodial Assets totaled \$10.5 billion, up 48% year over year.

Segmental Performance

Service Revenues: At this segment, revenues totaled \$87.6 million, up significantly from the year-ago quarter's \$25 million on organic growth of 16% in average HSA.

Custodial Revenues: At this segment, revenues grew 48.8% year over year to \$47 million, attributable to growth in HSA assets and 2.48% higher year-over-year annualized interest rate yield on HSA cash assets.

Interchange Revenues: At this segment, revenues improved 62.1% year over year to \$22.5 million. Per management, the upside was driven by increase in average total accounts, including contributions from WageWorks.

Margin Details

HealthEquity registered gross profit of \$96 million, up significantly from the year-ago quarter's \$45.8 million. Gross margin was 61.1% of net revenues, down 390 bps year over year.

Sales and marketing expenses summed \$12.7 million, up 68.7% year over year. Technology and development expenses totaled \$23.5 million, up from \$8.7 million in the second quarter of fiscal 2019. General and administrative expenses amounted to \$19.2 million, up from the prior-year quarter's \$9.2 million.

Operating income in the fiscal third quarter was \$9.9 million, down 47.7% year over year. Operating margin totaled 6.3% in the quarter, down significantly from the year-ago quarter's 26.9%.

Guidance

HealthEquity raised its revenue guidance for fiscal 2020.

The company now expects revenues between \$520 million and \$526 million, much higher than the earlier projected range of \$341-\$347 million.

Adjusted net income is projected between \$101 million and \$105 million, much above the earlier stated range of \$76-\$80 million.

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Valuation

HealthEquity's shares are down 1.1% in the year-to-date period while up 30.7% in the trailing 12-month periods. Stocks in the Zacks sub-industry are down 0.1% while the Zacks Medical sector is up 0.7% in the year-to-date period. Over the past year, the Zacks sub-industry is down 9.9% and sector is up 7.3%.

The S&P 500 index is up 1.6% in the year-to-date period and 27.9% in the past year.

The stock is currently trading at 6.43X Forward 12-months sales, which compares to 3.05X for the Zacks sub-industry, 2.83X for the Zacks sector and 3.51X for the S&P 500 index.

Over the past five years, the stock has traded as high as 18.84X and as low as 5.09X, with a 5-year median of 11.32X.

Our Outperform recommendation indicates that the stock will perform better than the market. Our \$84 price target reflects 7.4X forward 12-months sales.

The table below shows summary valuation data for HQY.

Valuation Multiples - HQY					
		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	6.43	3.05	2.83	3.51
	5-Year High	18.84	3.91	3.8	3.51
	5-Year Low	5.09	2.36	2.42	2.54
	5-Year Median	11.32	2.78	2.93	3
EV/SALES TTM	Current	15.42	9.43	3.33	3.28
	5-Year High	22.21	9.66	4.15	3.3
	5-Year Low	6.24	2.84	2.91	2.16
	5-Year Median	13.52	3.8	3.41	2.8

As of 01/09/2020

Industry Analysis Zacks Industry Rank: Top 33% (85 out of 254)



Top Peers

Credit Suisse Group (CS)	Outperform
Fidelity National Financial, Inc. (FNF)	Outperform
Alliance Data Systems Corporation (ADS)	Neutral
Citigroup Inc. (C)	Neutral
Deutsche Bank Aktiengesellschaft (DB)	Neutral
JPMorgan Chase & Co. (JPM)	Neutral
UBS Group AG (UBS)	Neutral
Wells Fargo & Company (WFC)	Neutral

Industry Comparison Industry: Medical Services				Industry Peers		
	HQY Outperform	X Industry	S&P 500	C Neutral	FNF Outperform	JPM Neutral
VGM Score	F	-	-	D	C	D
Market Cap	5.19 B	276.29 M	23.84 B	174.83 B	12.63 B	431.08 B
# of Analysts	10	4	13	7	2	4
Dividend Yield	0.00%	0.00%	1.79%	2.55%	2.87%	2.62%
Value Score	F	-	-	B	C	C
Cash/Price	0.03	0.07	0.04	4.53	0.17	2.33
EV/EBITDA	66.87	-0.62	13.88	-8.41	11.68	-3.91
PEG Ratio	1.95	1.65	2.02	0.82	NA	1.87
Price/Book (P/B)	5.08	4.40	3.33	0.98	2.47	1.83
Price/Cash Flow (P/CF)	58.53	15.25	13.76	9.28	13.56	11.35
P/E (F1)	48.83	21.21	18.76	9.48	13.94	13.12
Price/Sales (P/S)	12.77	3.03	2.63	1.71	1.62	3.04
Earnings Yield	2.05%	3.94%	5.32%	10.55%	7.18%	7.63%
Debt/Equity	1.25	0.07	0.72	1.36	0.16	1.26
Cash Flow (\$/share)	1.25	-0.02	6.94	8.63	3.39	12.11
Growth Score	D	-	-	F	B	F
Hist. EPS Growth (3-5 yrs)	47.76%	26.58%	10.56%	13.07%	9.28%	15.31%
Proj. EPS Growth (F1/F0)	26.13%	24.96%	7.46%	9.28%	-0.90%	0.35%
Curr. Cash Flow Growth	58.34%	10.28%	14.83%	19.03%	-8.72%	23.43%
Hist. Cash Flow Growth (3-5 yrs)	69.98%	16.71%	9.00%	5.10%	5.36%	7.08%
Current Ratio	1.91	1.47	1.23	1.00	0.99	0.93
Debt/Capital	55.49%	34.72%	42.99%	55.14%	18.75%	54.37%
Net Margin	13.03%	-9.85%	11.08%	18.28%	9.82%	24.70%
Return on Equity	11.31%	-21.92%	17.16%	10.16%	17.51%	14.63%
Sales/Assets	0.34	0.70	0.55	0.05	0.79	0.05
Proj. Sales Growth (F1/F0)	82.33%	10.67%	4.16%	1.63%	-0.77%	0.02%
Momentum Score	F	-	-	F	F	A
Daily Price Chg	-0.11%	0.00%	0.39%	0.91%	0.66%	0.37%
1 Week Price Chg	-2.99%	0.00%	-0.30%	0.04%	0.16%	-0.57%
4 Week Price Chg	2.30%	3.78%	2.38%	3.93%	-2.83%	-0.42%
12 Week Price Chg	27.95%	8.80%	6.40%	15.06%	1.82%	14.20%
52 Week Price Chg	30.73%	-9.19%	22.97%	41.88%	35.05%	36.91%
20 Day Average Volume	682,860	140,109	1,610,101	11,211,890	998,349	9,316,014
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-0.32%	0.00%	0.18%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-1.16%	-2.03%	0.58%
(F1) EPS Est 12 week change	29.25%	-1.75%	-0.50%	-0.95%	4.60%	1.02%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-2.08%	1.73%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	F
Growth Score	D
Momentum Score	F
VGM Score	F

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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