

HealthEquity, Inc.(HQQ)

\$57.51 (As of 08/17/20)

Price Target (6-12 Months): **\$49.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 07/15/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:F

Value: D

Growth: C

Momentum: F

Summary

HealthEquity underperformed its industry in a year's time. Sluggishness in adjusted operating and gross margin raises concern. 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. HealthEquity exited first-quarter fiscal 2021 on a dull note, with earnings and revenues missing estimates. Nonetheless, the company witnessed strong growth in Service, Custodial and Interchange segments in the last reported quarter. Notably, solid growth in HSAs and custodial assets bolstered the top line. HealthEquity accelerated its integration efforts of the previously-closed WageWorks buyout and anticipates to achieve the previously-announced goal of \$50 million in run rate synergies by the end of the fiscal second quarter.

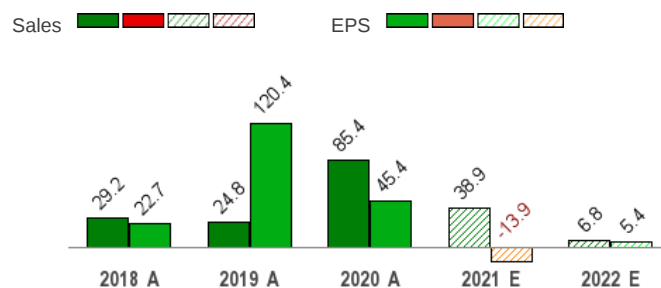
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$88.78 - \$34.40
20 Day Average Volume (sh)	671,270
Market Cap	\$4.1 B
YTD Price Change	-22.4%
Beta	1.42
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Medical Services
Zacks Industry Rank	Bottom 32% (171 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-2.3%
Last Sales Surprise	-1.3%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	09/08/2020
Earnings ESP	0.0%
P/E TTM	33.1
P/E F1	38.6
PEG F1	1.7
P/S TTM	6.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	196 E	190 E	192 E	199 E	789 E
2021	190 A	171 E	177 E	196 E	739 E
2020	87 A	87 A	157 A	201 A	532 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$0.32 E	\$0.26 E	\$0.29 E	\$0.28 E	\$1.57 E
2021	\$0.43 A	\$0.30 E	\$0.34 E	\$0.37 E	\$1.49 E
2020	\$0.41 A	\$0.45 A	\$0.47 A	\$0.39 A	\$1.73 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 08/17/2020. The reports text is as of 08/18/2020.

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:

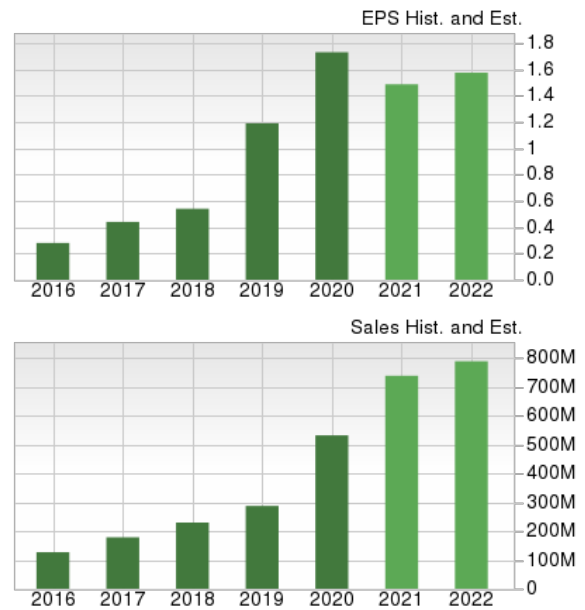
- Service revenues
- Custodial revenues
- Interchange revenues

FY20 at a Glance

In fiscal 2020, HealthEquity reported revenues of \$531.9 million, up 85.2% year over year. The top line also outpaced the Zacks Consensus Estimate by 0.2%.

The company reported adjusted net income of \$1.17 per share, down 9.3% year over year. The figure also missed the Zacks Consensus Estimate of \$1.67 by 29.9%.

While Service revenues accounted for 49% of net revenues, Custodial revenues contributed 31%. Meanwhile, Interchange revenues accounted for 16% of net revenues.



Reasons To Sell:

- ▼ **Shares Down:** Over the past year, shares of HealthEquity have declined 5.7% against the industry's rise of 15.1%. Intense competition and contraction in margins continue to weigh on the stock. Further, the ongoing economic volatility on account of the global coronavirus outbreak is hampering the stock.
- ▼ **Margins Fail to Impress:** In the fiscal first quarter, gross margin was 56.9% of net revenues, down 947 bps year over year. Adjusted operating margin totaled 24.5% in the quarter, contracting 901 bps year over year.
- ▼ **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.

HealthEquity faces stiff competition in the Medical Services markets. The company deals with high level of sensitive personal data. Any form of security breaches might hamper business prospects.

Risks

- **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 Apr 30, 2020, the total number of Health Savings Accounts (HSAs), for which HealthEquity served as a non-bank custodian (HSA members), was 5.4 million, up 33% year over year. Additionally, total Active HSA assets were \$11.5 billion, up 38% year over year. Total Accounts, including HSAs and complementary CDB accounts, came in at 12.7 million, up 169% year over year.

- **Guidance Solid:** For the fiscal second quarter, the company expects revenues between \$168 million and \$173 million. Adjusted net income is projected between \$17 million and \$22 million. Adjusted EPS is expected within 23-30 cents.

The guidance includes the effect of \$40 million achieved in annualized run rate net synergies at the end of the fiscal first quarter as well as achieving the goal of \$50 million in total run rate synergies by the end of second quarter. Realization of synergies is expected to prove accretive to both the top and the bottom line in fiscal year 2021 and beyond.

- **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.

In January 2020, the company launched Investment Desktop 2.0, an elevated, digital platform experience, revolutionizing the way members manage and grow their HSAs. The new desktop makes it convenient and more cost-efficient to invest with HealthEquity.

- **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. Per the calendar 2019 Devenir HSA Research Report, Devenir projects that HSA assets grew 23%, while HealthEquity assets improved 29%. At calendar year end, HealthEquity came number one with market share of 19% with respect to HSAs and a close second by HSA assets at 16%.

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 added other administrative and retirement services for regional employers.

Recently, the company deployed the first phase of its unified experience as its first HSA asset migrations were completed. The company is also on track to complete the onshoring around the clock member service in the second quarter of fiscal 2021.

HealthEquity expedited its integration efforts (WageWorks buyout that closed on Aug 30, 2019) and now anticipates to achieve the previously-announced goal of \$50 million in run rate synergies, including the on-shoring of all telephone-based member services to the United States by the end of the fiscal second quarter. In the fiscal first quarter, member call satisfaction scores on legacy WageWorks platforms improved 10 percentage points on robust performance by the company's front line team members and onshoring calls.

In the fiscal first quarter, the company finished its fourth legacy platform migration and is on track to deliver six to eight more in fiscal 2021. Currently, more than half of HSAs and HSA assets have been migrated.

- **Stable Liquidity Positon:** The company exited first-quarter fiscal 2021 with cash and cash equivalents of \$171 million, down from \$192 million in the last-reported quarter. The company's long-term debt came in at \$1.25 billion, flat sequentially. Meanwhile, current-year debt was \$60 million, up from \$51 million in the preceding quarter. So we can see that the current year debt is considerably lower than the cash and cash equivalent level. This is good news in terms of the company's solvency level as it has enough cash for debt repayment even during such trying times. The total debt to capital came at 55.7% which represents a slight sequential decrease from 55.8%.

Last Earnings Report

HealthEquity Q1 Earnings and Revenues Miss Estimates

HealthEquity, Inc. reported adjusted earnings per share of 43 cents in first-quarter fiscal 2021, which missed the Zacks Consensus Estimate of 44 cents by 2.3%. The bottom line was flat on a year-over-year basis.

Revenues in Detail

The company generated revenues of \$190 million, missing the Zacks Consensus Estimate by 1.3%. However, the figure skyrocketed 118% from the prior-year quarter.

HSA Member Detail

As of Apr 30, 2020, the total number of Health Savings Accounts (HSA), for which HealthEquity served as a non-bank custodian (HSA members), was 5.4 million, up 33% year over year.

Additionally, total Active HSA assets were \$11.5 billion, up 38% year over year.

Total Accounts, including HSAs and complementary CDB accounts, came in at 12.7 million, up 169% year over year.

Segmental Performance

Service Revenues: At this segment, revenues totaled \$111.3 million, up 315.3% from the year-ago figure.

Custodial Revenues: At this segment, revenues grew 11.9% year over year to \$46.9 million.

Interchange Revenues: At this segment, revenues soared 73.8% year over year to \$31.8 million.

Margin Details

HealthEquity generated gross profit of \$108.1 million, up 87.1% from the year-ago quarter. Gross margin was 56.9% of net revenues, down 947 bps year over year.

Adjusted operating profit in the fiscal first quarter was \$46.5 million, up 59.6% year over year. Adjusted operating margin totaled 24.5% in the quarter, contracting 901 bps year over year.

Guidance

Due to uncertainty regarding the impact of the COVID-19 pandemic, the company is withdrawing its fiscal 2021 guidance.

For the fiscal second quarter, the company expects revenues between \$168 million and \$173 million. The Zacks Consensus Estimate for the same is pegged at \$190.7 million.

Adjusted net income is projected between \$17 million and \$22 million.

Adjusted EPS is expected within 23-30 cents. The Zacks Consensus Estimate for earnings is pegged at 45 cents.

Quarter Ending 04/2020

Report Date	Jun 02, 2020
Sales Surprise	-1.29%
EPS Surprise	-2.27%
Quarterly EPS	0.43
Annual EPS (TTM)	1.74

Valuation

HealthEquity's shares are down 22.4% and 5.7% in the year-to-date and trailing 12-month periods, respectively. Stocks in the Zacks sub-industry and Zacks Medical sector are up 11.4% and 0.4% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry is up 15.1% while the sector is up 7.6%.

The S&P 500 index is up 4.5% in the year-to-date period and up 15.4% in the past year.

The stock is currently trading at 5.4X Forward 12-months sales, which compares to 3.4X for the Zacks sub-industry, 2.8X for the Zacks sector and 3.7X for the S&P 500 index.

Over the past five years, the stock has traded as high as 18.8X and as low as 3.4X, with a 5-year median of 11.1X.

Our Underperform recommendation indicates that the stock will perform below the market. Our \$49 price target reflects 4.6X 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	5.36	3.37	2.80	3.70
	5-Year High	18.84	3.44	3.41	3.70
	5-Year Low	3.43	1.95	2.22	2.53
	5-Year Median	11.11	2.48	2.89	3.05
EV/SALES F12M	Current	6.89	3.71	3.23	3.35
	5-Year High	17.78	3.80	3.64	3.52
	5-Year Low	4.23	2.01	2.49	2.28
	5-Year Median	10.30	2.60	3.17	2.86

As of 08/17/2020

Industry Analysis Zacks Industry Rank: Bottom 32% (171 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
LHC Group, Inc. (LHCG)	Outperform	1
Apollo Medical Holdings, Inc. (AMEH)	Neutral	3
BioTelemetry, Inc. (BEAT)	Neutral	3
Natera, Inc. (NTRA)	Neutral	4
NovoCure Limited (NVCR)	Neutral	3
Progyny, Inc. (PGNY)	Neutral	3
RTI Surgical, Inc. (SRGA)	Neutral	4
Teladoc Health, Inc. (TDOC)	Neutral	4

Industry Comparison Industry: Medical Services				Industry Peers		
	HQY	X Industry	S&P 500	AMEH	BEAT	TDOC
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	4
VGM Score	F	-	-	B	A	C
Market Cap	4.11 B	242.94 M	23.75 B	905.45 M	1.47 B	16.65 B
# of Analysts	8	3	14	1	3	10
Dividend Yield	0.00%	0.00%	1.62%	0.00%	0.00%	0.00%
Value Score	D	-	-	C	C	F
Cash/Price	0.04	0.07	0.07	0.29	0.06	0.09
EV/EBITDA	42.05	1.03	13.49	16.88	16.71	-1,620.56
PEG Ratio	1.70	2.49	3.03	4.34	2.61	NA
Price/Book (P/B)	3.95	4.22	3.18	4.32	3.82	12.86
Price/Cash Flow (P/CF)	27.17	18.14	12.85	16.20	12.73	NA
P/E (F1)	38.65	27.05	22.17	21.69	26.10	NA
Price/Sales (P/S)	6.47	3.52	2.49	1.36	3.37	23.25
Earnings Yield	2.59%	2.46%	4.32%	4.61%	3.82%	-0.69%
Debt/Equity	1.20	0.07	0.77	1.11	0.41	0.73
Cash Flow (\$/share)	2.12	-0.01	6.94	1.04	3.37	-0.50
Growth Score	C	-	-	A	A	A
Hist. EPS Growth (3-5 yrs)	46.14%	23.54%	10.44%	NA	43.01%	NA
Proj. EPS Growth (F1/F0)	-14.09%	-3.79%	-5.97%	81.40%	-15.73%	-3.12%
Curr. Cash Flow Growth	92.12%	8.67%	5.22%	7.37%	4.16%	-9.57%
Hist. Cash Flow Growth (3-5 yrs)	52.91%	15.17%	8.52%	NA	49.60%	NA
Current Ratio	2.11	1.53	1.33	2.50	2.52	11.36
Debt/Capital	54.55%	29.15%	44.59%	68.01%	29.15%	42.27%
Net Margin	-0.05%	-2.77%	10.13%	3.24%	4.42%	-13.22%
Return on Equity	9.48%	0.24%	14.51%	11.69%	17.68%	-9.54%
Sales/Assets	0.29	0.60	0.51	0.88	0.62	0.40
Proj. Sales Growth (F1/F0)	38.83%	0.00%	-1.67%	0.00%	-0.24%	79.16%
Momentum Score	F	-	-	B	A	F
Daily Price Chg	-0.79%	0.00%	-0.02%	-2.20%	-0.46%	9.34%
1 Week Price Chg	12.98%	-1.81%	1.09%	0.76%	-0.97%	-3.21%
4 Week Price Chg	1.84%	0.39%	4.83%	1.44%	4.37%	-9.79%
12 Week Price Chg	1.27%	9.94%	13.09%	-1.40%	-5.59%	17.71%
52 Week Price Chg	-5.72%	-12.82%	2.77%	7.43%	3.67%	235.44%
20 Day Average Volume	671,270	199,573	1,932,479	55,643	373,813	5,106,837
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	1.80%	18.18%	10.05%	-23.74%
(F1) EPS Est 12 week change	-20.40%	0.00%	2.88%	4.00%	10.05%	-25.56%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.80%	NA	-6.83%	-24.44%

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	D
Growth Score	C
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.

Disclosures

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