HealthEquity Inc

Portfolio M&A and internal innovations: Investor Day takeaways

Reiterate Rating: BUY | PO: 93.00 USD | Price: 82.26 USD

22 February 2024

Equity

Cap deployment: HSA portfolios and internal investments

This morning, we attended HealthEquity's Investor Day in Salt Lake City, Utah. The event centered around the strategy to drive growth above market and double adjusted EPS growth over the next three years. HealthEquity answered our biggest question heading into the event: how will the company deploy capital? Over the intermediate term, HealthEquity expects to continue portfolio M&A and build internal innovations (pointing to its new cost transparency tool and digital CDB cards). This strategy minimizes risk while allowing the company to participate in optionality from new investments. HQY spent substantial time speaking about its partnership ecosystem, how it's beginning to leverage data integrations and how it can influence member outcomes. We come away from the Investor conference incrementally confident HQY is investing to further solidify its moat in the HSA space. We view the goal to double adjusted EPS as a reasonable target and believe investors will reward the incremental clarity. Reiterate Buy.

More details on Enhanced Yields

HQY provided more details on its Enhanced Yield strategy and answered questions we had around its new custodial cash disclosure. HQY is able to drive higher adoption into Enhanced Yields (from 30% of cash to 60% in FY27) because it auto-enrolls new members into Enhanced yields and will begin to move consumers into Enhanced Yields unless they opt out. HQY is capturing Treasuries + 75 bps on Enhanced Yield products vs Treasuries + 10 bps on its basic product. The 3.8% yield in FY28 is lower than we expected because: 1) it includes a higher level of its basic rates product and contributions from Further, when rates were materially lower than today. We estimate basic rates/enhanced rates are 4%+/5%+ today. Another important point is that the Enhanced rate product is not FDIC insured while the basic rates product are.

Doubling adjusted EPS by FY27 provides clearer road map

HQY's goal to double adj. EPS by FY27 includes benefits from higher custodial yields, new account/asset growth and managing service costs more effectively. Importantly, we think this disclosure also includes a reasonable base level of share repurchases. None of these drivers strike us as particularly surprising and we think the company has strong line of sight into this three-year target as long as rate volatility is not outsized. We update our estimates to reflect higher earnings in the outer years.

More details in the body of the note,

Estimates (Jan) (US$)	**2022A**	**2023A**	**2024E**	**2025E**	**2026E**
EPS	1.33	1.36	2.23	2.79	3.32
GAAP EPS	(0.53)	(0.31)	0.58	1.07	1.41
EPS Change (YoY)	-20.8%	2.3%	64.0%	25.1%	19.0%
Consensus EPS (Bloomberg)			2.14	2.84	3.53
DPS	0	0	0	0	0
Valuation (Jan)					
P/E	61.8x	60.5x	36.9x	29.5x	24.8x
GAAP P/E	NM	NM	141.8x	76.9x	58.3x
EV / EBITDA*	32.7x	28.4x	21.1x	16.9x	15.3x
Free Cash Flow Yield*	1.8%	2.1%	4.4%	5.0%	5.5%

* For full definitions of *iQmethod*SM measures, see page 18.

Key Changes

(US$)	Previous	Current
2024E EPS	2.13	2.23
2026E EPS	3.00	3.32
2024E EBITDA (m)	357.5	366.3
2026E EBITDA (m)	485.6	505.6

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Stock Data

Price	82.26 USD
Price Objective	93.00 USD
Date Established	16-Feb-2024
Investment Opinion	C-1-9
52-Week Range	48.86 USD - 83.86 USD
Mrkt Val (mn) / Shares Out (mn)	7,157 USD / 87.0
Free Float	97.9%
Average Daily Value (mn)	50.43 USD
BofA Ticker / Exchange	HQY / NAS
Bloomberg / Reuters	HQY US / HQY.OQ
ROE (2024E)	9.9%
Net Dbt to Eqty (Jan-2023A)	34.5%
ESGMeter™	**Medium**

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

See inside for Glossary

iQprofile[SM] HealthEquity Inc

*iQ*method [SM] – **Bus Performance***

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	5.2%	5.0%	7.4%	8.9%	9.8%
Return on Equity	6.8%	6.1%	9.9%	11.8%	13.1%
Operating Margin	24.5%	22.9%	29.8%	31.9%	33.8%
Free Cash Flow	132	147	317	360	390

*iQ*method [SM] – **Quality of Earnings***

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.3x	1.3x	1.7x	1.5x	1.4x
Asset Replacement Ratio	0.1x	0x	0.1x	0.1x	0.1x
Tax Rate	22.7%	25.0%	25.0%	23.3%	22.5%
Net Debt-to-Equity Ratio	38.1%	34.5%	19.2%	4.1%	-0.5%
Interest Cover	5.1x	4.1x	5.4x	6.2x	7.0x

Income Statement Data (Jan)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	757	862	997	1,158	1,235
% Change	3.1%	13.9%	15.7%	16.1%	6.7%
Gross Profit	435	506	641	770	845
% Change	2.7%	16.4%	26.6%	20.1%	9.7%
EBITDA	236	272	366	456	506
% Change	-2.0%	15.4%	34.5%	24.4%	10.9%
Net Interest & Other Income	(43)	(45)	(38)	(45)	(45)
Net Income (Adjusted)	**110**	**115**	**194**	**248**	**288**
% Change	**-12.7%**	**3.9%**	**69.1%**	**28.3%**	**15.9%**

Free Cash Flow Data (Jan)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	(44)	(26)	50	96	122
Depreciation & Amortization	137	161	159	181	181
Change in Working Capital	(13)	(36)	32	4	2
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	61	52	91	96	104
Capital Expenditure	(9)	(3)	(15)	(17)	(19)
Free Cash Flow	**132**	**147**	**317**	**360**	**390**
% Change	**-21.6%**	**11.5%**	**115.5%**	**13.3%**	**8.5%**
Share / Issue Repurchase	457	7	0	0	(225)
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	(53)	(9)	(35)	0	0

Balance Sheet Data (Jan)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	225	254	484	783	884
Trade Receivables	87	97	93	108	115
Other Current Assets	38	32	37	43	46
Property, Plant & Equipment	23	13	12	11	12
Other Non-Current Assets	2,732	2,693	2,613	2,530	2,441
Total Assets	**3,107**	**3,089**	**3,239**	**3,475**	**3,497**
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	144	131	164	190	201
Long-Term Debt	931	908	873	873	873
Other Non-Current Liabilities	179	154	180	208	222
Total Liabilities	**1,255**	**1,193**	**1,217**	**1,271**	**1,297**
Total Equity	**1,853**	**1,896**	**2,023**	**2,204**	**2,201**
Total Equity & Liabilities	**3,107**	**3,089**	**3,239**	**3,475**	**3,497**

* For full definitions of *iQmethod*[SM] measures, see page 18.

Company Sector

Healthcare Technology & Distribution

Company Description

HealthEquity provides a platform for health savings accounts (HSAs) that allows consumers to save for healthcare expenses in a tax efficient manner, compare treatment options, pay bills, and access benefits information. As of October 2023, the company had approximately 8.29MM health savings account (HSA) members and $22Bn in custodial assets. The company also purchased WageWorks in 2019 which added Commuter, COBRA, and flexible spending accounts.

Investment Rationale

Our Buy rating is driven by our positive view of operating leverage over the next few years. This is likely to be driven by improving custodial yields, accretion from recent M&A, as well as some improvement in the Commuter business. The HSA business should also continue to grow faster than the market over time.

Stock Data

Average Daily Volume	612,997

Quarterly Earnings Estimates

	2023	2024
Q1	0.27A	0.50A
Q2	0.33A	0.53A
Q3	0.38A	0.60A
Q4	0.37A	0.60E

Too early for clear benefits from digital shift, but...

It is too early to model any revenue contributions from HealthEquity's digital shift, but we think this transition creates optionality for new services. A significant amount of HealthEquity's digital usage occurs on the website today and we think the transition to get users to use a smartphone app first creates new opportunities. HealthEquity's pending price transparency tool and digital debit cards create clear reasons for patients to leverage the app and we expect the company to discuss more opportunities to leverage this in the future.

Partnerships and data integration a major focus

HealthEquity is generating a meaningful percentage of growth from partnerships. Three of four new sales today come from new partnerships and more than 40,000 HSA sales in FY24 came from partnerships. The company is aggressively investing in data and security to allow HealthEquity and its partners to leverage each other's unique datasets safely. For example, the company highlighted "Bluefit", a partnership with a Blues plan. That plan is designed around the HSA. The product has strong patient engagement as 95% of members have earned a wellness incentive.

Customer dashboard and other investments enhance moat

HealthEquity is investing in the experience for health plan and employer benefits managers, something that clearly differentiates itself from peers. HealthEquity's new tools for customers allows companies to manage and adjust the benefit design based on the specific spending patterns and economic situations of its patient population. We do not see how any players outside of the largest 2-3 HSA vendors can compete with these types of investments.

Income statement presentation to slightly change

Beginning with the FY24 10-k, HQY will make the following changes to income statement (I/S) presentation. Recordkeeping and investment advisory fees will move from Custodial Revenue to Service Revenue. For FY23, these fees accounted for ~7.7% of Custodial Revenue. HQY will also be moving vendor fees and personnel costs related to recordkeeping and investment advisory services from Custodial Costs to Service Costs and personnel related costs for corporate treasury to G&A. Based on FY23, this would reclassify ~10.3% of costs out of Custodial Costs with ~40% of that shifting to Service Costs and ~60% shifting to G&A.

Adjusting estimates and the cash maturity schedule

We update our FY4Q'24 ending asset and account balances to reflect the pre-announced balances of 8.692MM of HSAs, $25.214Bn of HSA assets, ~$15Bn of HSA cash and 15.698MM of total accounts. The updated balance rolls through our model to reflect slightly higher estimates. We increase our FY24 revenue estimate from $990.8MM to $997.5MM and our FY24 Adj. EBITDA estimate from $357.5MM to $366.3MM. The increase in revenue is driven by higher custodial revenue with the incremental high-margin revenue also driving the increase in adj. EBITDA. We note our model does not consider the above noted reclassification on the I/S. Lastly, we update the cash maturity schedule in our yield model to reflect the following cash maturities: $2.1Bn in FY25, $3.5Bn in FY26, and $3.2Bn in FY27. Our outyear EPS estimates increase to reflect better Service gross margins, OpEx leverage, and share repurchases. We now estimate FY27 EPS of $3.90 vs. $3.10 prior.

Investor Day Notes

Opening remarks

  - Record selling season, with CDBs even squeaking out growth
  - Have hit prior Investor Day goals and commitments (market share growth)
  - Intend to double non-GAAP net income per share
  - Historically it was about remarkable service, not about experience
- Chief Marketing Officer – Long range growth
  - Grow HQY HSA +CDB revenue share from ~20% to 30%+
  - ~33% of market share capture of HSA account growth per Devenir
  - 35MM of HSAs with $100Bn in assets in market
  - Deepen partnerships
    - Using technology to connect and extend ecosystem – 200+ partnerships
    - Drives new logo growth, underlying current behind experience growth
    - Powers sales and marketing productivity
  - Deliver remarkable experiences
    - Make frictionless experience
    - Cross sell products to members
  - Driving member outcomes
    - Improve healthcare outcomes – how to do it in the future
    - Aspirational development
    - Volume growth – attracting new members to services, improving retention
    - Employers most happy when employees are happy
- Deepening partnerships by EVP of Sales and Relationship Management
  - Health plan partners value retention and growth
  - Blue's plans noted that those with HQY HSAs have higher retention – so there is interest in integrating more closely with HQY
  - Growing both HSA and 401(k) growth with Vanguard
  - 3 out of 4 new sales were with integrated partnerships
  - 40K+ new HSA sales from new partnerships in FY24

- Partners are outsourcing consumer directed benefits
  - Onboarded 3 partners that have supported 40K+ member growth already
  - Blues Arizona – about 45K accounts across 800 employers
- Greater expectations of secure data exchange
  - Employers want to work with someone they trust
  - Nearly 80% of clients said broker influenced their decision
  - Partner growth strategy builds trust and growth
- Increasing number of partners associated with deals
  - Brokers favor HSA providers that can partner/integrate with their partners
  - Driven by value that members/employers receive from integrated deals (greater value)
  - Employer tied to integrated health plan and 401(k) plan – nudges from 401(k) and HSA provider to drive assets into these plans
- If all benefits were integrated together, it would drive more value. Intend on selling more CDB related products through more partners than ever before
- Digital selling models helps to scale faster
  - Broker portal – brokers drive more than half of small group sales (55%)
  - Broker portal has improved to help brokers self-serve
    - Track client progress and open accounts directly through the portal

- Technology and capital investments - Chief Technology Officer
  - Working to become a benefits hub
  - Want to deliver more value in a seamless manner
  - Distinguishes HQY from others:
    - Integrated customers with ecosystem
    - Enabling innovation from external partners to incorporate within own solutions
  - Expedites innovation to market, but difficult to reach this level given required trust/investments. Hard to emulate
  - Have shifted capital allocation overtime - 70% was initially to build systems for integration. Now 70% of spend is geared toward growth and innovation

- Investments in privacy, unified data hub, and implementing real-time standardized API connectivity
- Have taken ideas from concept to production in 90 days
- Have focused on building out data
- Open ecosystem – connect to customers organically. Go to members with standard connectivity.
  - Customers have flexibility on integrating – can chose the solution that works for them
  - Moving from basic data sharing to bi-directional data sharing – enrich data from other sources and enhances value proposition of unified data hub. Can provide personal recommendations
- Blue Massachusetts Blue Fit example:
  - Rewards members on progress in health and fitness goals. Introduced in 2022. 95% of subscribers have earned an incentive
- API infrastructure
  - Bi-directional data exchange is new with real-time connectivity
  - Been in journey for a while
- Example integration with health plan – can help member and health insurance company by reminding of benefits or submitting claims. Timely contextual information provided to customer, easier processing for health plan partner
- Have built standard connectors out-of-the-box that decrease integration costs
- Payroll provider example. HQY on their app store. New data connectors will help drive savings -by reducing integration timeline with standard connectors, could reduce costs by 70% - $500k+ of potential savings
- Firstly – investments create a competitive environment. Creates tangible benefits (lower costs, easier connectivity, and swift access to data

- Integrated partnerships and remarkable experiences - Chief Operating Officer and Head of Product
  - Self service by members reduces costs
  - Digital service – mobile first experiences, real time insights and self service
  - One to many model helped improve marginal profit of all accounts
  - Early Q1 and 4Q usually erode some margins due to member onboarding

- Looking to spread out costs
- Members service expense is about 22% of costs of revenue - improved this by:
  - Reducing staffing costs
  - Automated high-volume interactions
  - Invested in digital experiences
- Self-help tools
  - Portal walkthroughs
  - 69% of members engage with self-help tools
  - Expanded chat program from human led to bot driven and soon to be AI-bot driven. Bots answer roughly 50% of inquiries
  - Building service leverage
- Mobile first interactions
  - Real time messaging/updates
  - Directing to HSA/FSA use cases
- Maturing technology, rising customer demand, and cash flow helping invest in products
- Digital card
  - Reduces cost of card issuance
  - Helps improve customer experience
  - Moved customers with multiple cards to a single card with intelligence to differentiate between accounts
  - Later this year – expect single intelligent card to be available on digital card
- How is this different from marketplace?
  - Multiple product suite in one single card
  - Adding support to request card digitally – solves one of the biggest friction points – waiting for physical card
  - No single competitor has everything together like HQY
- Flexible Spending Accounts
  - Forget to re-enroll and leave unused funds on the table at the end of the year. Because of this, there is more churn
  - Payment integration and education helps solve this

        - Basic education and reminders – helped improve re-enrollment rates by about 8%
        - Online integrations with online stores help with purchasing FSA eligible items through HQY integrated solutions
        - Opens up strong incremental revenue line through FSA shopping
        - Submitting receipts and getting reimbursed process is high friction and has high costs – piloting an AI driven product to automate this completely

- Client experience improvements
    - COBRA renewal
        - Made annual rate renewals seamless
        - Decreases churn
        - 82% of reimbursement account renewal volume occurs in 8-week window
        - 40% of reimbursement account renewal processing time reduce by fully automated plan renewals
    - Eventual goal to help clients have a self-serve portal – broker portal is a big first step toward this
- Driving member outcomes
    - Innovation is about igniting outcomes on products
    - Member outcomes help drive logo growth
    - E-commerce company example
        - Modernized plan design – reduced HSA plan premiums by $25, and added default employee contribution by $25
        - 95% of employees are now contributing to HSAs
        - Costing company 11% less than for members in PPO plan
    - Clients opting in annual open enrollment education drove 11% new account rate vs. 8% with education
    - Education only goes so far- it is about designing the portfolio and making the progress frictionless
    - Employers use HSA eligible plans to drive down costs
- Trends – affordable comprehensive benefits
    - Consumers are battling high costs
    - 401(k) record keeper note that most early withdrawals are for medical costs

    - Employers and employees believe employer should solve issues on affordability for health

- Employer insights
    - Will begin scaling reporting to help self-support
    - Will use AI to help drive benefits design
    - Using very heavily with privacy/governance teams to comply with application regulations
    - Enables informational dashboard, provides KPIs relevant to client, allows to deploy actions directly, can do post-campaign analysis
    - Sharing trends with clients – spenders vs. savers for example
    - Using AI and machine learnings to help cluster scores – benchmarking
    - AI recommends potential impact from taking
    - Scale and size will help drive usage of tools and improve insights
    - Engaged with 60MM members
- Partnering with provider to help pay out of pocket fees without credit risk
    - Driven by partners
    - R.R Donnelley a example
- Incentivizing preventative care to drive down costs
- HQY driving client costs reductions by supporting price transparency
    - Helps find lower costs in real time
    - Using claim data
- Accelerate go to market by bringing other products/add-on solutions to clients – example improving members health and financial outcomes

Finance

- Shifting components of revenue/cost items
    - Custodial revenue – interest earned on custodial cash, record keeping and investment fees
        - Moving record keeping and investment fees to Service Revenue
    - Vendor fees and personnel related costs moving from custodial costs to service costs
    - Personnel related costs moving from custodial to G&A
- Have doubled enhanced rate program capacity
- Cash maturity schedule

  - Ended FY24 with $15Bn in cash assets – excluding BenefitWallet assets
  - Most economists forward curve expectations – maturing yields are well new rates expected
- Why enhanced rates?
  - Will reduce variable rate exposure/add stability
  - Insurance partners help make daily inflow/outflows – implicit liquidity in contracts by reducing variable exposure from 10% to 0%
  - Extended duration to 4.5yrs vs. 2.5yrs in basic rates contracts
  - Basic rates reprice end of the term – 5 years, enhanced rates reprice 10% every year
  - Expect higher highs and lows in basic rates programs – enhanced rates is ~30% of total HSA cash
  - Mostly from new accounts and acquired cash
  - Starting this year, moving expiring contract cash to enhanced rates – expect 10%/yr increase in enhanced rates as % of cash through FY27
- Three-year goal to double non-GAAP net income per share over the next three fiscal years
  - Custodial cash with enhanced rates to support at least 3 years of rising yield
    - Material custodial revenue expected
    - With realignment on revenue, custodial revenue will be only line item on revenue with link to market yields
  - Interchange – highly correlated to account growth. Member economics should stay same
  - Service revenue – driven by member growth. Expecting to bend the cost curve on service costs
    - Driving electronic communication, using mobile, using robotic process automation and AI. Stacked cards and mobile wallet to reduce plastic/paper costs
  - Multiple tools to double adj. EPS over the next three years

<u>Q/A</u>

- Broker portal?
  - 55% of small group sales coming through broker portal
  - Differentiate through integrated partnerships
  - Health plans work with favorite brokers and vice versa. Relationships with brokers is what differentiates

- Help bridge gap on win rates vs. clients?
    - Cutting 70% of the costs through standardized connectors
    - Cost to integrate to employer – 70% of savings
    - Bigger deal for smaller employers
- Three quarters of sales through partnership channel? How much was it before?
    - Partner model has produced between 2/3rds to more than 75% of sales through partnership
    - Feel that 75% coming through partner channel is right level
    - When sell direct, brings client to health plan relationship or other integrated relationship
- How much growth was from network partners? What percentage of partners is health plans vs. brokers etc.? Where do you think competitors stand in relation to number of partners?
    - Looking back – partnerships have grown over the years
    - Had less years ago than what is there today. What is nature of partnership
    - It's about integrating with multiple types of partners to drive benefits
    - Majority of partnerships are health plans, payroll/record keeper partnerships are lesser, but growing
- What are the economics on a partner channel vs. direct sale?
    - Qualified lead gen/flow – time to create opportunity vs. using partner – velocity is higher and probability of winning is higher (so is retention levels)
- How much improved win rates are coming from data/bi-directional API's data?
    - Doubled down on efforts – created a client advisory board (20 of largest clients) to get insights
    - Design thinking sessions to convert product to market in 90 days
    - Expedited claims from this innovation market
    - Lead with an element of the three D's, but listen to customer and gather insights from customers and cater message to them
- What are competitors doing in reacting to product innovation by HQY?
    - There isn't likely a integrated portal like HQY's
    - AI receipt reimbursement – probably first to market
- Bots an AI bots, where are you in deploying this technology?
    - Late last year, put together a multi-year service technology roadmap

  - Brought people including folks with technology experience (robotic processing)
  - Chat has been highly effective
  - Lots of opportunity to bring down costs

- What percentage of CDB consumers have downloaded the app? Has the use of the HealthEquity app increased over the year? What percentage of members have digital card today?
  - Very high percentage of users use digital means to interact with HQY
  - Penetration is higher on web side. Mobile side growing
  - 60-70% of interactions are digital – a lot on web portal
  - Digital card – Not live today. Have a stacked card with all accounts that was recently released
  - Will enable members to access the digital stacked card very soon
- How do you envision the future of the app? Product roadmap?
  - Once more people use the app – can use the power of the mobile app
  - One example – payment receipt reimbursement
  - Mobile shopping for FSA eligible items
  - Notification/reminders become more actionable
- What percentage of cost structure involves physical cards and where are we on removing cards?
  - Plastics/paper mailed – remainder of 83% bucket of cost of sales expense
    - Hard costs and well as staff costs
  - Chip cards have value – reduces fraud/improves security
  - Contactless card
  - Some conversion processes – first one done, second one done
  - Will get to a place where HQY does not ship a plastic card. Instance issuance of digital cards. After moving to single processor
- Transitioning from bots to AI bots? What does AI brings incrementally?
  - Chat journey started with human chats. Invested in curating content in last 12-18 months
  - Watching how members comments on questions, having human curate content to improve experience, but can now use AI to help curate that
  - Client chat is also going well, will layer AI on that as well

- ADP and Paychex got high engagement by dashboard. What are you planning to do with increased engagement?
    - Partners love the solutions because of engagement 20x more through system
    - Engagement will drive outcomes, but will help with client engagement
    - There is high line of sight into needs
- Price transparency tool, is it hundred percent access to partners?
    - Using several partners – the cover is very high. Quality/privacy of data is high
    - Seems very accurate- but there are things to improve there. Will take to production
- Key assumptions on the long-term growth algorithm? Below the line and in-organic? Moving pieces in growth algorithm?
    - Included number is BenefitWallet contribution – later this Q
    - Sales and marketing line – in good spot as % of revenue
    - Technology and Development line – high point as % of revenue – re-deploying capital
    - Merger-integration line – came down, but expect it to come down
    - No material market shifts – will see what Devenir report says. Not assuming massive curve bending, just winning above market rates
    - No inorganic included outside of BenefitWallet
- Mechanics with regards to enhanced yield product? How does deployment work? Considerations that would be a structural change? 10% deployed annually – is it per contract?
    - Have an algorithm that invests clients cash
    - Bank product is not going away – will remain a large part of the portfolio but will be a smaller percentage of total assets
- Service revenue growth per account – trend has been down- how can you drive better margins?
    - Pricing pressure – unit/revenue per customer lower.
    - Avg/revenue per customer is a big mix-shift. CDB is a higher service revenue per account (main CDB is from service line)
    - Headline pricing pressure in HSA service costs and mix higher of HSA accounts is what is driving pressure in service revenue per account
    - Before – was declining in CDBs, but growing there will help
- As you execute on insurance partners, how does it change the premium?
    - Bilateral negotiations – dependent on ability to negotiate a strong deal

- How should we think about exposure to front-end of the curve?
    - Probably in a good place., $500MM in 3Q and around $700MM in 4Q. Will fluctuate a bit through migration to enhanced rates. As the enhanced product grows, less need for overnight liquidity buckets
- Credit product – no balance sheet risk? How is that monetized?
    - Revenue share component for activating and usage
- Is there a lower limit on what you plan to do portfolio M&A?
    - View that small ball acquisitions as semi-organic growth. Part of the growth strategy. Paying acquisition price as a commission
    - Continuing to bring in a small block of HSAs. Getting a big deal done this year with BenefitWallet
- Enhanced rates products 65bps above basic products. How is increased yield split between customers?
    - Do share bit of enhanced rates with member. Custodial cost line increases with mix to enhanced rates. Sharing a piece of upside
    - Both are bank rate products so have exposure to 5yr treasury – there is still volatility
    - Enhanced rates – have shown better performance over multiple cycles
- Enhanced rates long-term?
    - 85% of new dollars going into enhanced products… maybe get to 80/20 in enhanced rates products
    - Assets in FDIC deposit insurance may grow if assets grow
    - Guidelines on insurance partners – department labor guidelines on pension partners and kick it up a notch. Ratings acceptance and don't want to be significant component of anyone's balance sheet. Takes various annuity providers that are PE backed ones off the board.
    - Given up some premium for quality. Further was using this model entirely but using a state regulated subsidiary of an insurance provider.
    - Insurers stability vs. banks is pretty good – although bank is FDIC backed
- What is the next natural adjacency or sizable market? What looks attractive in M&A or end-markets?
    - See returns to deployment of capital in portfolio style construction and organic development
    - Developing tools to address client needs
    - Generative AI will eat particularly consumer facing applications – those that work through business channels. Ai will eat navigation and transparency

- Going to deploy capital to grow at edges of business HQY is in. Very adjacent and primarily developed through creation of new businesses or buying something
- Trying to find ways to help drive down costs in healthcare – reminders on colonoscopy
- Empowering healthcare consumers – HSA investments , HQY makes less money on those, but it results in more dollars added to accounts
- Most wellness programs have <10% adoption, but program at HQY has 55%+

- Marrying bi-direction data – can steer members, can you get value from that?
  - Contributes to service line on revenue
  - Increase utilization and diversity offering more personally
  - Opportunity to diversity the sources available – company in eyewear business and middle of February talking about using FSA. HealthEquity can bring those companies on to the platform and help drive members there.
- Benchmarking tool – add on or rolling out to everybody?
  - Want to get in the hands of clients that provided feedback in development (at no cost)
  - Do believe there is an analytics opportunity with clients and consultants/brokers
  - Brokers/consultants are basically blind on what consumers are seeing, and can help them see
- How do you think competition will evolve over the next 3-5 years? Could there be new entrants that could disrupt things? To what extent do you think you can accelerate?
  - Started out competing against banks – banks have left the space largely. Companies like Third-Party Administrators there.
  - Three big name competitors – Fidelity – make a big deal about it, but how do you drive it as a health benefit
    - United will be united – have tried to sell to other health plans, but other health plans don't like that
    - Startups that help health plan keep the economics
    - In competitive RFPs – health plans may have 300k HSAs, but HQY is doing it in scale, so it helps
    - Benefit enrollment, tech companies trying to support DIY options
  - Top 20 providers, 19 of them where in the business when Jon joined. Regulatory barriers are high

  - Scale and level of capital intensity are friends. When Nikki talks to regulation – what do you want to do? Let's show you how to do it? Regulation doesn't hurt us, it helps us. Fiduciary rule coming back helps HQY. Movement to AI/data hubs help HQY.
    - United and Fidelity have the same capacity to do it, but there strategic priorities might not be aligned
    - Empowering healthcare consumers is a big complex and capital intensive

- Free cash flow numbers over the coming years look promising? What is view on capital allocation and use of cash?
  - No new news to report
  - BenefitWallet will lever and then de-lever (will pay down)
  - Fund business, pursue accretive acquisitions and will pay down debt after getting leverage to 1.5-2x
  - Returning capital – a little time before having that discussion

- Pretty uncommon for Healthtech to have big 4 plus a top 10? Is there some mass consolidation coming?
  - It's an industry where low barriers to entry – but high barriers to success
  - Long tail of folks with very small number of accounts with no capacity to grow beyond that
  - Scale can help invest in differentiation. Not surprised with structure. Expect consolidation to continue at a modest pace
  - Healthcare and banking is local. Kind of mirrors the banking industry

Glossary

CDB – Consumer-directed benefits

HSA – Health Savings Account

API – Application Programming Interface

FSA – Flexible Savings Account

COBRA **–** Consolidated Omnibus Budget Reconciliation Act directed continuation of health coverage

RFP – Request for Proposal

PE – Private Equity

PPO – Preferred Provider Organization

Price objective basis & risk

HealthEquity Inc (HQY)

Our $93 price objective is based on c.18.5x our CY24E EBITDA estimate. This represents a 1-2 turn premium to peers. We believe HQY should trade at a premium to peers given HQY's depressed EBITDA base, faster top-line growth, and rates optionality.

Downside risks to our PO are any long-term changes in demand for Commuter benefits from a broader shift in preference to work from home could permanently impair that part of the business. Additional downside risks to our PO are inability to drive expected revenue/operational synergies from recent M&A, and slower-than-expected growth from the HSA market and changes in interest rates. Less significant risks are new entrants to the market gaining share and fewer opportunities to acquire peer portfolios from companies exiting the HSA market.

Analyst Certification

I, Allen Lutz, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Healthcare Technology & Distribution Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Accolade	ACCD	ACCD US	Allen Lutz, CFA
	American Well Corp	AMWL	AMWL US	Allen Lutz, CFA
	Cencora Inc	COR	COR US	Allen Lutz, CFA
	CVS Health	CVS	CVS US	Allen Lutz, CFA
	Definitive Healthcare Corp	DH	DH US	Allen Lutz, CFA
	dentalcorp	YDNTL	DNTL CN	Allen Lutz, CFA
	Envista	NVST	NVST US	Allen Lutz, CFA
	HealthEquity Inc	HQY	HQY US	Allen Lutz, CFA
	Hims & Hers	HIMS	HIMS US	Allen Lutz, CFA
	McKesson	MCK	MCK US	Allen Lutz, CFA
	Omnicell Inc.	OMCL	OMCL US	Allen Lutz, CFA
	Patterson Companies	PDCO	PDCO US	Allen Lutz, CFA
	Progyny	PGNY	PGNY US	Allen Lutz, CFA
	R1 RCM	RCM	RCM US	Allen Lutz, CFA
NEUTRAL				
	Cardinal Health	CAH	CAH US	Allen Lutz, CFA
	Dentsply Sirona, Inc.	XRAY	XRAY US	Allen Lutz, CFA
	Doximity Inc	DOCS	DOCS US	Allen Lutz, CFA
	Teladoc Health	TDOC	TDOC US	Allen Lutz, CFA
UNDERPERFORM				
	GoodRx	GDRX	GDRX US	Allen Lutz, CFA
	Henry Schein	HSIC	HSIC US	Allen Lutz, CFA
	Owens & Minor	OMI	OMI US	Allen Lutz, CFA
	Premier, Inc.	PINC	PINC US	Allen Lutz, CFA
	Walgreens Boots Alliance	WBA	WBA US	Allen Lutz, CFA

iQmethod SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5 Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings	**Numerator**	**Denominator**
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt – Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit	**Numerator**	**Denominator**
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap = Current Share Price × Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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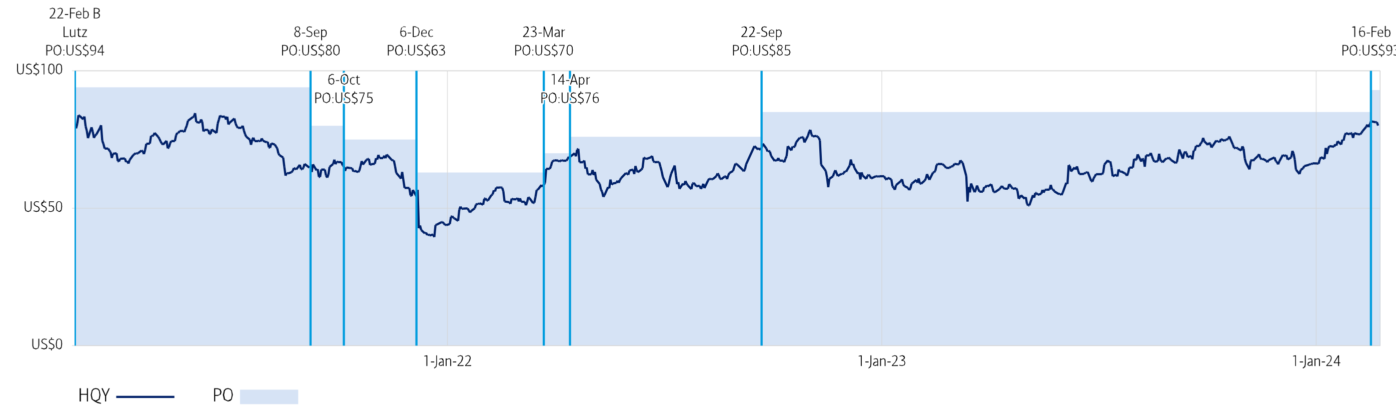
HealthEquity (HQY) Price Chart



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Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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