

Healthcare Technology & Distribution

HCT&D Trending Thoughts – McKesson, Accolade, and convertible notes

Industry Overview

Catching up on recent HCT&D group debates

Our “weekly” report touches on key controversies/debates over the past week and where we stand on the most important/relevant topics currently dominating discussion in the Health Care Tech & Distribution sector. This won’t be comprehensive of everything going on in our universe, but rather it tries to capture some of the most popular debates we are currently having. We maintain ratings on our coverage companies.

NYC marketing feedback: Long McKesson

We held marketing meetings during the first half of the week in New York City. The distributors are clear favorites within the investment community given the sub-industry’s recession resistant characteristics. Among the three distributors, MCK is the preferred name by what seems to be a wide margin, due in large part to the company’s prior authorization business that is helping drive an acceleration in revenue and profitability within the Prescription Technology Solutions business. One key question is, “are shares expensive at 15x EPS, given shares were at 10-12x over the past few years?” We argue that investors should look at a longer time horizon for more context. MCK traded at 15-16x EPS from 2010-2013 in a normalized environment and then the multiple expanded north of 20x during the generic inflation boom (an environment that is unlikely to repeat again) that ended in 2016-2017. Shares briefly held in at 15-16x EPS before trading down to 10-12x during the opioid overhang period that lasted until 2021. The recent multiple expansion to 15-16x represents a return to a normalized multiple following this period. With MCK pointing to 13-16% EPS growth and a stronger non-pharmaceutical asset base than any time in the past 15 years, the current multiple appears reasonable.

Accolade and the 4Q ramp

The biggest question following ACCD’s earnings last week is, “how achievable is the 4Q EBITDA ramp?” Accolade historically has a steep 4Q ramp, but it is clear that this particular ramp is slightly steeper than the past two years. Accolade has done a good job cutting operating expenses through the first two quarters of the year to offset the loss of a major customer, even as organic revenue growth is 19% (excluding that customer). Conversations with brokers and consultants continue to point to significant investor interest in navigation and Accolade remains a leading player. Overall, Accolade has significant runway for revenue growth and we view the recent organic growth rate in today’s more challenging environment as validation the model is resonating.

Healthcare IT and the convertible notes

Over the past several weeks, investors are increasingly focused on balance sheet dynamics for digital health players. Many companies in the space took advantage of cheap convertible financing during COVID and those notes will be coming due in 2025 and 2026. The new question from investors is how companies are thinking about the refinancing and potential dilution dynamics in a higher interest rate environment.

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Equity
United States
Healthcare Technology & Distribution

Allen Lutz, CFA
Research Analyst
BofAS
+1 646 855 4380
allen.lutz@bofa.com

Hanna Lee
Research Analyst
BofAS
+1 646 855 3682
hanna.y.lee@bofa.com

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Exhibit 1: Stocks mentioned

Prices and ratings for stocks mentioned in this report

Ticker	Company Name	Stock Price	Rating
MCK	McKesson	\$445.80	B-1-7
ACCD	Accolade	\$8.47	C-1-9

Source: BofA Global Research

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Price objective basis & risk

Accolade (ACCD)

Our \$16.00 price objective is based on about 2.4x our CY24 EV/revenue estimate. We utilize the group of high-growth health IT companies as our universe, which all have a mix of software/internet-deployed capabilities alongside incremental high-touch services. Our valuation assumes a premium to the non-telehealth HCIT universe trading at about 2.1x sales due to its significant total addressable market (TAM), strong growth potential (even if on a revenue basis below some of the other names), and combination of both recent margin capture and incremental margin opportunity over time.

Downside risks are member attrition due to increased unemployment (in particular the two large airline customers), the ability to deliver on new customer wins, incremental spending in order to support new customer growth, delivering on its cost savings targets (particularly for the portion of at-risk revenue), maximizing the benefits from the 2nd.MD acquisition, and competition both from other standalone tech-enabled players and traditional carriers. Upside risks are better upsell to the Total Health & Benefits offering, capitalizing on expansion outside of the traditional self-insured employer market, and faster-than-expected demand for new employer customers.

McKesson (MCK)

Our \$492 price objective is based on roughly 16.5x our CY24 EPS estimate. This multiple is in line with/slightly above the long-term year average and is essentially in line with the S&P 500 multiple. This multiple contemplates MCK's attractive long-term growth profile relative to peers in the index.

Downside risks to our PO are incrementally worse drug pricing pressure, increased competition creating gross profit headwinds, the risk of other disruptive force entering the supply chain market, ongoing uncertainties and headlines related to the opioid litigation process, any volatility tied to COVID-related utilization drop-offs, any impact from changes in customer standing, and lack of available attractive capital deployment opportunities.

Upside risks are any potential volume pickup, increases in buy-side/sell-side spreads, increasing contribution from COVID vaccines and other related products, and further opportunities for cost savings or capital deployment contributions post-health IT divestiture.

Analyst Certification

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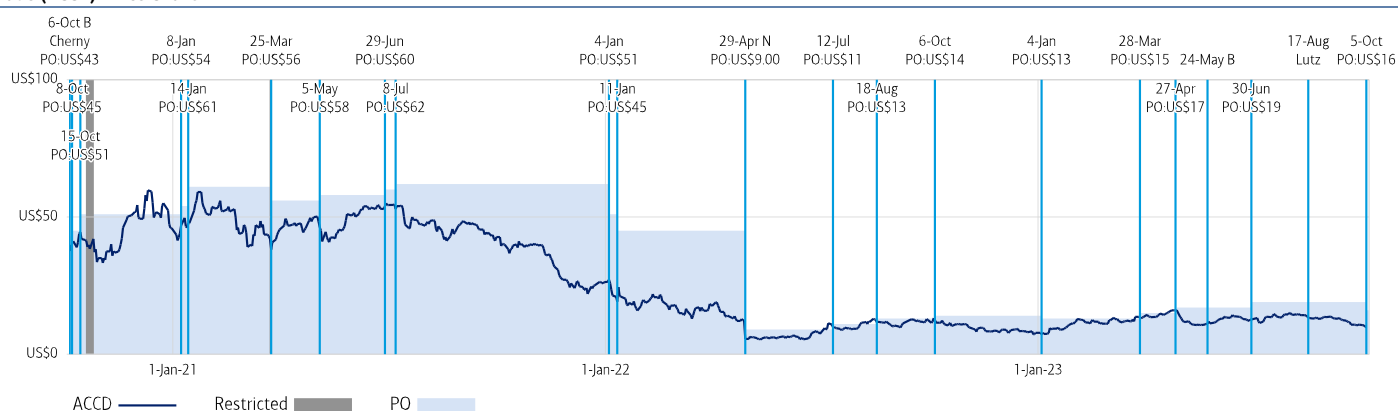
US - Healthcare Technology & Distribution Coverage Cluster

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
	dentalcorp	YDNTL	DNTL CN	Allen Lutz, CFA
	Envista	NVST	NVST US	Allen Lutz, CFA
	GoodRx	GDRX	GDRX 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
	Omniceil 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
	Sonendo Inc	SONX	SONX US	Allen Lutz, CFA
NEUTRAL				
	Cardinal Health	CAH	CAH US	Allen Lutz, CFA
	Definitive Healthcare Corp	DH	DH US	Allen Lutz, CFA
	Dentsply Sirona, Inc.	XRAY	XRAY US	Allen Lutz, CFA
	Teladoc Health	TDOC	TDOC US	Allen Lutz, CFA
UNDERPERFORM				
	Doximity Inc	DOCS	DOCS 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

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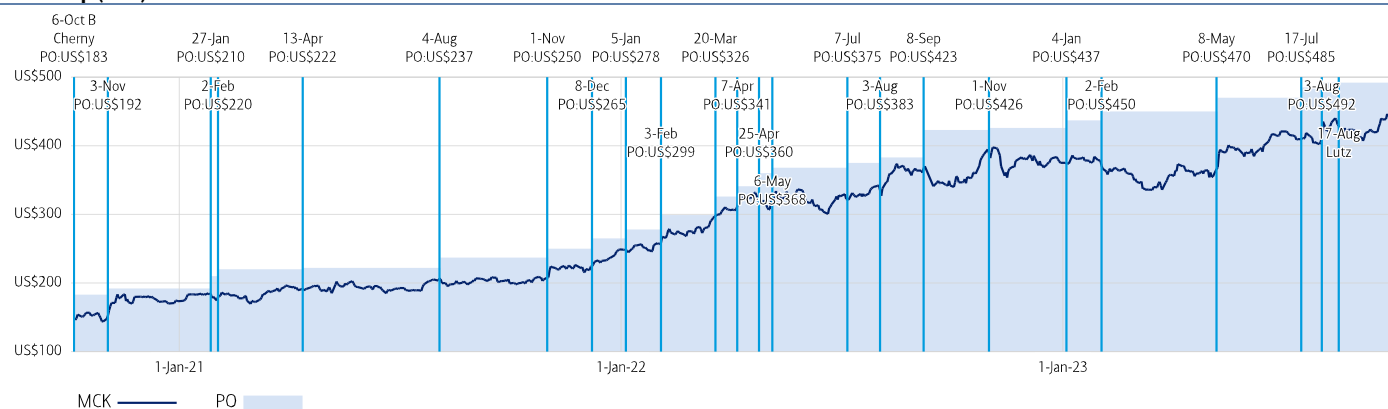
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Accolade (ACCD) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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McKesson Corp (MCK) Price Chart

B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Equity Investment Rating Distribution: Health Care Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	233	60.21%	Buy	113	48.50%
Hold	83	21.45%	Hold	33	39.76%
Sell	71	18.35%	Sell	25	35.21%

Equity Investment Rating Distribution: Global Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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