

HealthEquity Inc

BenefitWallet deal could be 8-14%+ accretive to run-rate FY25 EPS

Maintain Rating: BUY | PO: 85.00 USD | Price: 70.95 USD

Framing the upside to earnings

HealthEquity's acquisition of BenefitWallet's Health Savings Accounts (HSAs) could be 8-14%+ accretive to FY25's EPS run-rate once all tranches are transferred. The timing of when the transaction closes is unclear and the company expects to transition accounts in a wave of 3-4 tranches over the next few quarters. This could result in a lower accretion for FY25 than the stated numbers based on timing. However, HealthEquity will likely be able to place the acquired cash at prevailing market rates, which are significantly above HealthEquity's current custodial yield. In Exhibit 1 [* MERGEFORMAT * MERGEFORMAT](#), our scenario analysis 1 assumes HealthEquity captures a 3.00% custodial yield on new cash, resulting in \$53MM incremental gross profit and 8.6% accretion to FY25 EPS. In Exhibit 2, our scenario analysis 2 assumes HealthEquity captures a 4.5% custodial yield on new cash, resulting in \$70MM incremental gross profit and 14.2% accretion. These models assume a 50/50 split on debt/cash, a 7.25% interest rate on debt and a 5% opportunity cost of debt. We think one of the reasons HealthEquity stock has not risen more dramatically this year is because FY25 EBITDA estimates have not risen since November 2022. Prior to today, consensus FY25 EBITDA is \$406MM. We have long viewed our estimate of \$442MM as conservative and have articulated how HQY could theoretically generate \$500MM+ of EBITDA next year ([link to note here](#)). Today's news could theoretically add another \$30MM+ of EBITDA to these estimates with the full run-rate representing \$50MM over more. We plan to review our estimates following deal close. We remain positive on HQY; maintain Buy.

Estimates (Jan) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	1.33	1.36	2.02	2.71	2.91
GAAP EPS	(0.53)	(0.31)	0.25	0.84	0.94
EPS Change (YoY)	-20.8%	2.3%	48.5%	34.2%	7.4%
Consensus EPS (Bloomberg)			2.00	2.59	NA
DPS	0	0	0	0	0
Valuation (Jan)					
P/E	53.3x	52.2x	35.1x	26.2x	24.4x
GAAP P/E	NM	NM	283.8x	84.5x	75.5x
EV / EBITDA*	27.8x	24.1x	18.9x	14.8x	13.9x
Free Cash Flow Yield*	2.2%	2.5%	4.8%	5.7%	6.0%

* For full definitions of *IQmethod*SM measures, see page 6.

19 September 2023

Equity

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Stock Data

Price	70.95 USD
Price Objective	85.00 USD
Date Established	22-Sep-2022
Investment Opinion	C-1-9
52-Week Range	48.86 USD - 79.20 USD
Mrkt Val (mn) / Shares Out (mn)	5,960 USD / 84.0
Average Daily Value (mn)	38.50 USD
BofA Ticker / Exchange	HQY / NAS
Bloomberg / Reuters	HQY US / HQY.OQ
ROE (2024E)	9.0%
Net Dbt to Eqty (Jan-2023A)	34.5%
ESGMeter TM	Medium

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iQprofileSM HealthEquity Inc

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	5.2%	5.0%	6.9%	8.7%	8.9%
Return on Equity	6.8%	6.1%	9.0%	11.6%	11.7%
Operating Margin	24.5%	22.9%	27.9%	31.6%	32.1%
Free Cash Flow	132	147	288	339	356

iQmethodSM – 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%	25.1%	23.3%	22.9%
Net Debt-to-Equity Ratio	38.1%	34.5%	20.9%	6.4%	-6.6%
Interest Cover	5.1x	4.1x	5.1x	6.6x	7.1x

Income Statement Data (Jan)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	757	862	989	1,128	1,199
% Change	3.1%	13.9%	14.8%	14.0%	6.3%
Gross Profit	435	506	622	744	808
% Change	2.7%	16.4%	23.0%	19.5%	8.7%
EBITDA	236	272	346	442	471
% Change	-2.0%	15.4%	27.1%	27.6%	6.6%
Net Interest & Other Income	(43)	(45)	(42)	(42)	(42)
Net Income (Adjusted)	110	115	175	241	264
% Change	-12.7%	3.9%	53.0%	37.2%	9.9%

Free Cash Flow Data (Jan)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	(44)	(26)	21	75	85
Depreciation & Amortization	137	161	157	179	179
Change in Working Capital	(13)	(36)	32	3	2
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	61	52	92	99	108
Capital Expenditure	(9)	(3)	(15)	(17)	(18)
Free Cash Flow	132	147	288	339	356
% Change	-21.6%	11.5%	95.3%	17.8%	5.0%

Balance Sheet Data (Jan)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	225	254	455	735	1,027
Trade Receivables	87	97	92	105	112
Other Current Assets	38	32	37	42	44
Property, Plant & Equipment	23	13	12	11	11
Other Non-Current Assets	2,732	2,693	2,614	2,529	2,440
Total Assets	3,107	3,089	3,210	3,421	3,634
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	144	131	163	185	196
Long-Term Debt	931	908	873	873	873
Other Non-Current Liabilities	179	154	178	203	216
Total Liabilities	1,255	1,193	1,214	1,261	1,285
Total Equity	1,853	1,896	1,995	2,161	2,350
Total Equity & Liabilities	3,107	3,089	3,210	3,421	3,634

* For full definitions of iQmethodSM measures, see page 6.

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 February 2022, the company had approximately 7.2MM health savings account (HSA) members and \$20Bn 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 542,683

Quarterly Earnings Estimates

	2023	2024
Q1	0.27A	0.50A
Q2	0.33A	0.53A
Q3	0.38A	0.49E
Q4	0.37A	0.50E

Exhibit 1: Accretion Analysis – Scenario 1

We estimate \$0.23 of incremental FY25 EPS (8.6% accretion) on 3.0% custodial yield

Comments		
Service Fee Per Account	\$22.5	Assume 6% annual decline in service fees per account since FY18
Gross Margin %	30.0%	In-line with HQY margin
Service Fee Gross Profit Per Account	\$6.8	
Custodial Cash Per Account	\$1,750.0	HQY custodial cash per account
Custodial Yield	3.00%	Conservative placement rate
Custodial COGS	0.26%	
Custodial Cash Gross Profit Per Account	\$48.0	
Investments Per Account	\$2,310.2	Implied Investments per account assuming \$2.7Bn AUM
Invested Assets Fee	0.40%	
Custodial Investments Per Account	\$9.2	
Total Custodial Investments Gross Profit Per Account	\$57.2	
Interchange Revenue Per Account	\$19.0	\$15/account revenue in FY18. Estimate 5% growth for 5 years
Gross Margin %	83.0%	Current gross margin
Interchange Gross Margin Per Account	\$15.8	
Total Gross Profit Per Account	\$79.7	
Total Accounts	665,000.0	Press Release
Incremental Gross Profit Contribution in (\$MM)	\$53.0	
Total Consideration	\$425.0	
% Debt	50.0%	
Total Debt	\$212.5	
Interest Rate on New Debt	7.25%	Slightly higher than 7.03% yield on current debt
Incremental Interest	\$15.4	
Foregone Cash	\$212.5	
Foregone Interest Rate on Cash	5.00%	5% opportunity cost on cash
Foregone Interest Income	\$10.6	
Incremental Interest + Foregone Interest Income	\$26.0	
Pre-tax income	\$27.0	
Tax Rate	25.0%	HQY tax rate
Incremental Net Income	\$20.2	
Shares Outstanding	86.3	
Incremental EPS	\$0.23	
Original FY25 EPS	\$2.71	
Accretion %	8.6%	

Source: BofA Global Research

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Exhibit 2: Accretion Analysis – Scenario 2

We estimate \$0.39 of incremental FY25 EPS (14.2% accretion) on 4.5% custodial yield

Comments		
Service Fee Per Account	\$22.5	Assume 6% annual decline in service fees since FY18
Gross Margin %	30.0%	In-line with HQY margin
Service Fee Gross Profit Per Account	\$6.8	
Custodial Cash Per Account	\$1,750.0	HQY custodial cash per account
Custodial Yield	4.50%	Prevailing market rate
Custodial COGS	0.26%	
Custodial Cash Gross Profit Per Account	\$74.2	



Exhibit 2: Accretion Analysis – Scenario 2

We estimate \$0.39 of incremental FY25 EPS (14.2% accretion) on 4.5% custodial yield

		Comments
Investments Per Account	\$2,310.2	Implied Investments per account assuming \$2.7Bn AUM
Invested Assets Fee	0.40%	
Custodial Investments Per Account	\$9.2	
Total Custodial Investments Gross Profit Per Account	\$83.4	
Interchange Revenue Per Account	\$19.0	\$15/account revenue in FY18. Estimate 5% growth for 5 years
Gross Margin %	83.0%	
Interchange Gross Margin Per Account	\$15.8	
Total Gross Profit Per Account	\$106.0	
Total Accounts	665,000.0	Press Release
Incremental Gross Profit Contribution in (\$MM)	\$70.5	
Total Consideration	\$425.0	
% Debt	50.0%	
Total Debt	\$212.5	
Interest Rate on New Debt	7.25%	
Incremental Interest	\$15.4	Slightly higher than 7.03% yield on current debt
Foregone Cash	\$212.5	
Foregone Interest Rate on Cash	5.00%	5% opportunity cost on cash
Foregone Interest Income	\$10.6	
Incremental Interest + Foregone Interest Income	\$26.0	
Pre-tax income	\$44.4	HQY tax rate
Tax Rate	25.0%	
Incremental Net Income	\$33.3	
Shares Outstanding	86.3	
Incremental EPS	\$0.39	
Original FY25 EPS	\$2.71	
Accretion %	14.2%	

Source: BofA Global Research

BofA GLOBAL RESEARCH

Price objective basis & risk

HealthEquity Inc (HQY)

Our \$85 price objective is based on approximately 17-18x 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
	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



iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt +
Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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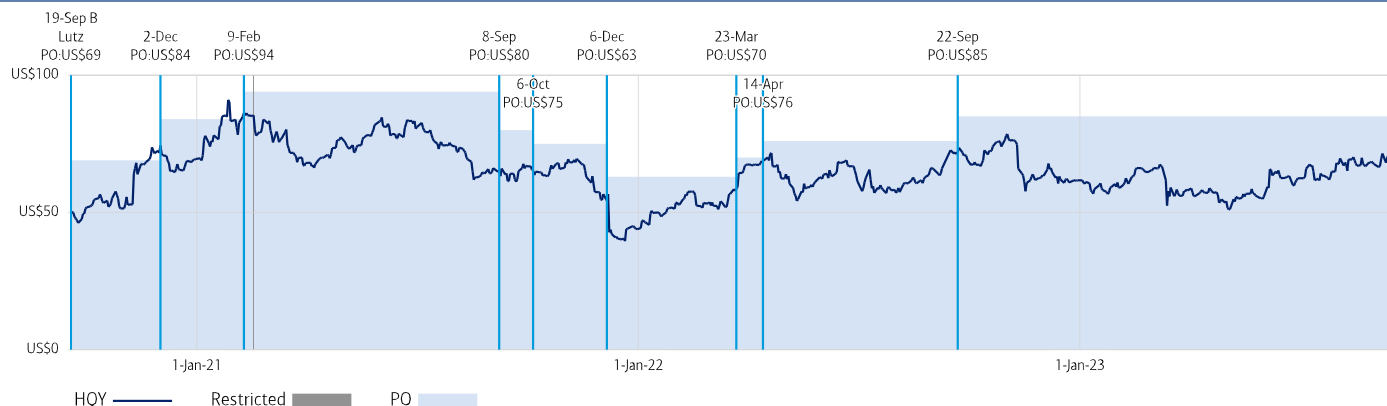
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HealthEquity (HQQ) Price Chart



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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	236	57.84%	Buy	105	44.49%
Hold	87	21.32%	Hold	38	43.68%
Sell	85	20.83%	Sell	22	25.88%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

^{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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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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