

HealthEquity Inc

Updating model build for new cash maturity schedule

Reiterate Rating: BUY | PO: 85.00 USD | Price: 72.20 USD

FY26/27 Custodial Revs de-risked on better yields

We believe HQY is even better positioned to navigate a step down in interest rates over the coming years than we had previously anticipated. In this note, we update our model to reflect the newly disclosed HSA cash maturity schedule (Exhibit 3), which provides better visibility into the company's maturing custodial cash contracts. HealthEquity will be repricing more low yielding contracts in FY26 and FY27 than we previously estimated. For example, the average yields replaced in FY4Q'24 and FY25 range between 3.1-3.4%, while the yields replaced in FY26 and FY27 will range from 1.4-1.6%. Our base case (Exhibit 1) has built-in conservatism in comparison to implied average yields based on current forward rates. This gives us incremental confidence in HealthEquity's ability to drive higher cash yields in the outer years amidst a backdrop of rate cuts in the coming years. Overall, we believe HealthEquity is better positioned to increase its custodial cash yield through FY27 than we previously estimated. As such, we increase the outer year cash yield, resulting in higher outer year custodial revenue and EBITDA estimates. Ultimately, this new disclosure should help investors gain more comfort in the duration of HealthEquity's current earnings power. We maintain our Buy rating and \$85 PO on c.17x CY24 EV/EBITDA (c.17.5x prior). We are slightly lowering our multiple to reflect peer multiple contraction (ADP/PAYX).

Exhibit 1: BofA estimated cash yields and implied average yields

The updated cash maturity schedule indicates HQYs custodial yields will be higher for longer

	2024E	2025E	2026E	2027E
Prior BofA cash yield estimate	2.47%	3.10%	3.20%	3.05%
New BofA cash yield estimate	2.47%	3.10%	3.20%	3.20%
Change in yield (bps)	0 bp	0 bp	0 bp	15 bp
Implied cash yield without dampner		3.10%	3.25%	3.37%

Source: BofA Global Research

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More details on the rate model build in the body of the note.

Estimates (Jan) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	1.33	1.36	2.13	2.79	3.00
GAAP EPS	(0.53)	(0.31)	0.43	1.02	1.12
EPS Change (YoY)	-20.8%	2.3%	56.6%	31.0%	7.5%
Consensus EPS (Bloomberg)			2.14	2.83	3.53
DPS	0	0	0	0	0
Valuation (Jan)					
P/E	54.3x	53.1x	33.9x	25.9x	24.1x
GAAP P/E	NM	NM	168.0x	70.8x	64.5x
EV / EBITDA*	29.1x	25.2x	19.2x	15.1x	14.1x
Free Cash Flow Yield*	2.1%	2.3%	4.9%	5.7%	5.9%

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

16 January 2024

Equity

Key Changes

(US\$)	Previous	Current
2025E EPS	2.71	2.79
2026E EPS	2.91	3.00
2025E EBITDA (m)	447.6	455.8
2026E EBITDA (m)	476.3	485.6

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Stock Data

Price	72.20 USD
Price Objective	85.00 USD
Date Established	22-Sep-2022
Investment Opinion	C-1-9
52-Week Range	48.86 USD - 76.62 USD
Mkt Val (mn) / Shares Out (mn)	6,281 USD / 87.0
Free Float	97.9%
Average Daily Value (mn)	65.27 USD
BofA Ticker / Exchange	HQY / NAS
Bloomberg / Reuters	HQY US / HQY.OQ
ROE (2024E)	9.4%
Net Dbt to Eqty (Jan-2023A)	34.5%
ESGMeter TM	Medium

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Timestamp: 16 January 2024 05:11AM EST

iQprofileSM HealthEquity Inc

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	5.2%	5.0%	7.1%	8.9%	9.1%
Return on Equity	6.8%	6.1%	9.4%	11.8%	11.9%
Operating Margin	24.5%	22.9%	28.9%	31.7%	32.2%
Free Cash Flow	132	147	305	358	373

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%	25.0%	23.2%	22.7%
Net Debt-to-Equity Ratio	38.1%	34.5%	19.9%	4.7%	-8.6%
Interest Cover	5.1x	4.1x	5.2x	6.2x	6.7x

Income Statement Data (Jan)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	757	862	991	1,158	1,231
% Change	3.1%	13.9%	15.0%	16.9%	6.3%
Gross Profit	435	506	628	763	829
% Change	2.7%	16.4%	24.2%	21.5%	8.6%
EBITDA	236	272	358	456	486
% Change	-2.0%	15.4%	31.3%	27.5%	6.5%
Net Interest & Other Income	(43)	(45)	(41)	(45)	(45)
Net Income (Adjusted)	110	115	185	247	272
% Change	-12.7%	3.9%	61.1%	34.1%	9.9%

Free Cash Flow Data (Jan)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	(44)	(26)	37	91	102
Depreciation & Amortization	137	161	158	182	182
Change in Working Capital	(13)	(36)	32	5	2
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	61	52	92	98	106
Capital Expenditure	(9)	(3)	(15)	(17)	(18)
Free Cash Flow	132	147	305	358	373
% Change	-21.6%	11.5%	107.1%	17.4%	4.1%
Share / Issue Repurchase	457	7	0	0	0
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	472	770	1,078
Trade Receivables	87	97	92	108	115
Other Current Assets	38	32	37	43	46
Property, Plant & Equipment	23	13	12	11	11
Other Non-Current Assets	2,732	2,693	2,613	2,530	2,440
Total Assets	3,107	3,089	3,226	3,462	3,689
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	178	208	222
Total Liabilities	1,255	1,193	1,215	1,271	1,296
Total Equity	1,853	1,896	2,012	2,190	2,394
Total Equity & Liabilities	3,107	3,089	3,226	3,462	3,689

* 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 903,999

Quarterly Earnings Estimates

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

Updating our rate model

We update our interest rate model (Exhibit 2) to reflect incremental confidence in HQY's ability to benefit from a longer rate tailwind. The updated model considers the newly disclosed cash maturity schedule (Exhibit 3) and builds in a lever of conservatism around yield increases. While the cash maturity schedule taken in context with the current forward market rates imply potential 15bps/12bps of y/y yield improvement into FY26/FY27 (Exhibit 2 ref c), we take a more conservative approach in our base case with yields holding steady from FY26 to FY27 (Exhibit 2 ref a). Lastly, while we hold our FY25 and FY26 yields in line with our prior estimates, we increase our FY27 cash yield from 3.05% to 3.20%.

Exhibit 2: Updated BoFA cash yield model

We update our rate model to reflect the update cash maturity schedule. We increase our FY27 base case yield to 3.20%

New Interest Rate Model		2024E	2025E	2026E	2027E
BoFA Custodial Yield Estimate		2.47%	3.10%	3.20%	3.20%
1		FY24	FY25	FY26	FY27
Live Case			3.10%	3.20%	3.20%
a	Base		3.10%	3.20%	3.20%
b	Base case vs. implied model (bps difference)		0.0 bp	-5.0 bp	-17.0 bp
	Bear case		2.70%	2.80%	2.80%
	Bull case		3.10%	3.25%	3.37%
c	Average Yield Model	3.0%	3.10%	3.25%	3.37%
d	Cash Rolling Off		1,600.0	3,300.0	3,000.0
e	Cash Rolling Off (% of Total)		10.0%	19.3%	16.4%
f	Liquid cash in 3-6 month rates (% of Total)		3.2%	3.2%	3.2%
g	Market Yield		3.76%	3.80%	3.90%
h	5 Year FWCM		3.76%	3.80%	3.90%
i	Spread		0.00%	0.00%	0.00%
j	Short term rate on liquid cash (6 month FWCM)		3.83%	3.59%	3.65%

Source: BoFA Global Research

BoFA GLOBAL RESEARCH

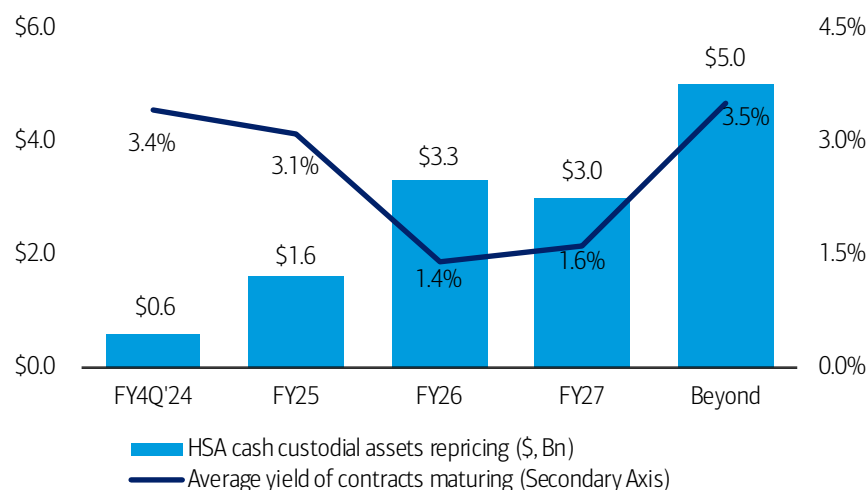
Yield model calculations (refer to Exhibit 2 for reference):

- Our live case considers a base case (ref a) which reflects a conservative lever (ref b) vs. the implied yield model (ref c)
- We calculate the implied average yield (ref c) as follows:
 - We estimate the % of cash rolling off annually (ref e) by taking the disclosed cash maturity schedule (ref d) and dividing by the estimated total HSA cash for the year.
 - We also estimate around 3.2% of total cash to be in more liquid form, invested in 3-to-6-month rates (ref f). We arrive at the 3.2% estimate for liquid cash based on management's commentary noting ~\$500MM of cash to meet HSA reimbursements for FY25.
 - We estimate the market yield (ref g) based on the spot rate for 5yr forward contracts and the short-term rates for liquid cash based on 6-month forward contracts (ref j).
 - We arrive at the average implied cash yield (ref c) using the following formula: $[(\text{Cash rolling off \%} \times \text{market yield}) + (\text{liquid cash \%} \times \text{short term cash rate}) + ((1 - \% \text{ of cashing rolling off} - \% \text{ of short-term cash}) \times \text{prior year's average yield})]$



Exhibit 3: HQY Cash maturity schedule

HQY expects the avg. yield of contracts maturing to be lower in FY26/27 vs. FY25



Source: Company reports, BofA Global Research

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Adjusting our model for recent disclosure and 4Q ending assets/account balances

Along with the rate model update, we update our FY4Q'24 ending asset and account balances to reflect the pre-announced balances. To refresh, the company expects to end FY24 with approximately 8.7MM of HSAs, \$24.5Bn of HSA assets, \$15Bn of HSA cash and 15.6MM of total accounts. The updated balance rolls through our model to reflect slightly higher estimates for FY25.

Our FY24 estimates for revenue and adj. EBITDA stay unchanged at \$990.8MM and \$357.5MM respectively. Our FY25 revenue increase slightly from \$1,149.1MM to \$1,157.5MM, driven by higher custodial revenues from a higher HSA asset base rolling forward from FY24. Our FY25 adj. EBITDA estimate increases from \$447.6MM to \$455.8MM as a result of the higher revenue.

Price objective basis & risk

HealthEquity Inc (HQY)

Our \$85 price objective is based on c.17x CY24E EBITDA estimate. This represents a 1-2 tum 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

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BUY				
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	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
	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
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



iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

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

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

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

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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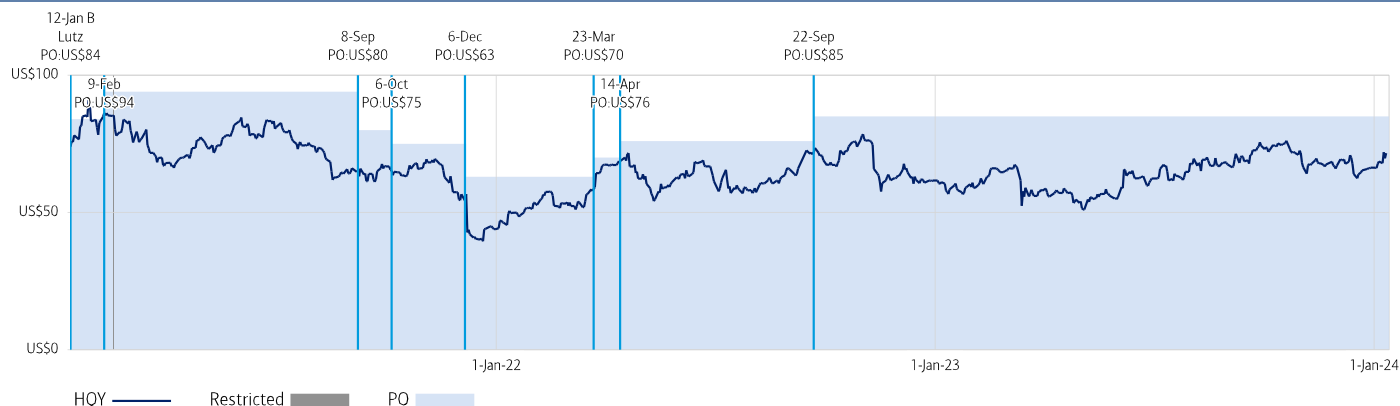
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Disclosures

Important Disclosures

HealthEquity (HQQ) Price Chart



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

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

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%

^{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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