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3/7/24

Short: Phreesia (PHR): $1.4b MC / $1.3b EV | $26 price vs. $18 fair value (-30%)

Note that PHR has a Jan 31 fiscal year. For simplicity, FY20 can be considered equivalent to CY19.

Overview:

Phreesia's core offering is a digitized patient intake process for a variety of healthcare settings (46% of FY24e revenue). It also offers payment facilitation (27%) and serves ads on those intake forms (27%).

Phreesia is a short due to a misunderstanding of the 'engine' of the business. Rather than being a SaaS business with ancillary revenue streams, the SaaS business is only semi-viable as a standalone business (5y+ simple gross profit payback, 90% gross / 95% net retention) and acts as a lead for payments, and especially advertising (referred to as "Network"). Management acknowledges and invites this understanding of the business, but investors are failing to understand how the next 3 years will differ from the past 3.

PHR Economics: Per Customer		
CAC (K)	$	200
Subscription Rev (K)	$	45
Payback		*5.23*
Network (Ad) Rev	$	27
Payback		*8.71*
Net Payment Rev	$	10
Payback		*23.53*
Total Avg Rev	$	82
Total Payback		*2.87*

Annual figures. Assumes 85% gross margin in each segment in payback calculation.

Thesis:

A year from now, the short will have worked as management maintained or slightly decreased S&M to meet the adj EBITDA guidance of FY25. Without this additional S&M investment, Phreesia was not able to add the ~550 clients expected by analysts. Phreesia ended up adding ~495, in part due to the higher acquisition costs that were apparent in FY24 but were clouded due to product acquisitions with immaterial levels of revenue, but with hundreds of clients.

As a result, PHR came within range of FY25 expectations but the deterioration in KPIs throughout the year led to a significant loss in confidence for out-year growth. This divergence in expectations was made especially apparent in its FY26 guidance. The stock re-rated to $18 to reflect this.

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Phreesia came public at $100m in FY19 revenue and will end FY24 at $354m. The advertising portion grew 5x over the timeframe, ahead of the subscription product at 3.7x, representing the expanding value of the network Phreesia serves, with ~5% of US patient visits facilitated under its intake software at the time of its IPO growing to +10% ~FY23-24 on the back of annual marketing spend expanding from $26m to $150m.

As management guides to $10-$20m in FY25 EBITDA from losses peaking at almost $100m in FY23, the market is misunderstanding what the new regime of 'profitable growth' will look like:

1. **The advertising business is Phreesia's gem and growth is directly tied to the size of the network; investors don't realize that they aren't betting on SaaS.** As Phreesia chooses to slow the pace of new client wins (implied by cost structure changes needed to reach FY25 guide), Phreesia loses the ability to grow advertising revenue based on volume (more patients) and price (network effects).
    a. The doubling of penetration from 2019-2023 ties directly with Ad revenue/Client, which grew from $13k to $26k (F4Qe annualized).
    b. Average Ad revenue/Client also fell slightly from FY23 to FY24e despite 26% client growth, representing the lack of value gained from acquisitions which bolster KPIs but not results.
    c. Investors are failing to understand that this is the profit center of the business, as the segment is essentially 100% incremental margin. Deterioration here disproportionately affects future estimates given the lackluster economics in the subscription product.

2. **Network growth is slowing for multiple reasons. Management is hiding this through acquisitions that aid KPIs rather than the business at large.** Client acquisition costs were aided by COVID's need for contactless solutions. The company correctly attacked this opportunity with a rapid increase in spending fostered by the ZIRP environment. Costs are now reverting to the mean given less greenfield opportunity and lower impetus on the part of customers, but recent M&A is distorting that trend.
    a. Taking the latest example with the ConnectOnCall acquisition: in F3Q24 Phreesia added 243 clients. 67 came from the Connect acquisition and 176 were presented as organic*. Total customer acquisition costs were $150k, but without the acquisition, they would have been 38% higher at $207k. This does demonstrate an improvement from pre-COVID (+$500k) but is more likely to revert to the mean based on greater competition.

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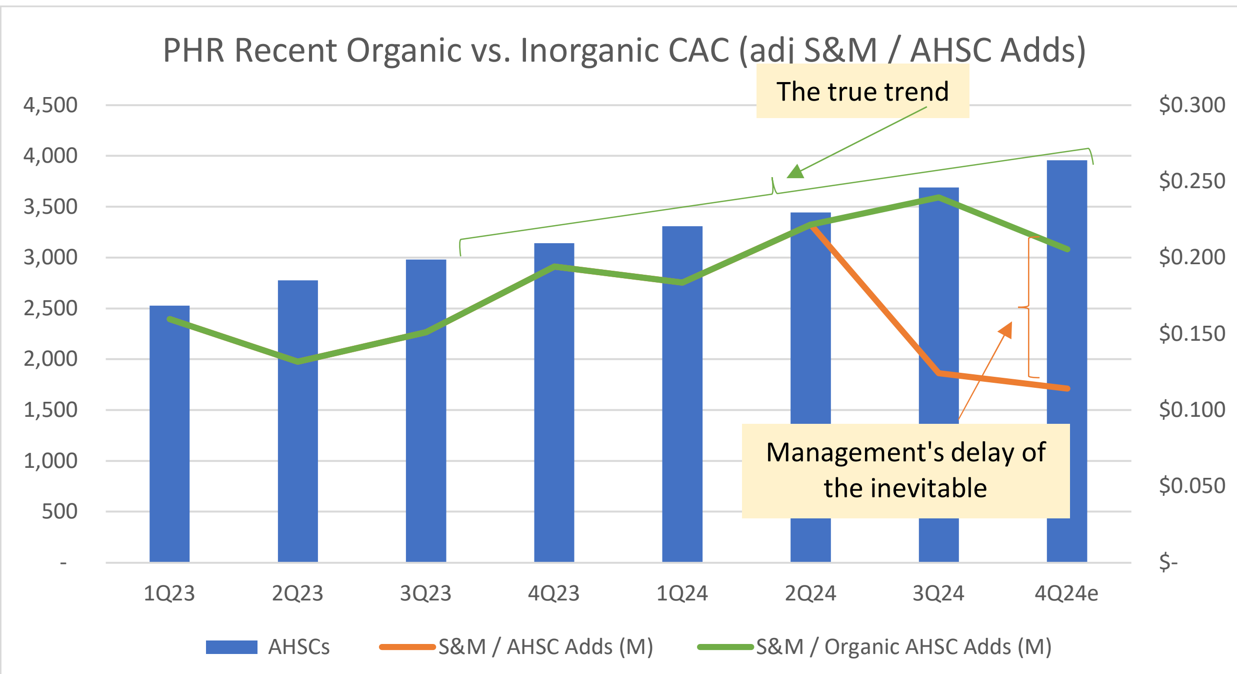
i. *F3Q24 also included the impact of another acquisition, Access eForms. Management mentioned in the 2Q letter that the 176 added in 3Q would include the impact of eForms but chose not to disclose the amount. In the 3Q letter they dropped the mention of eForms, presenting the 176 figure as organic. Based on the $37m paid and 1.6b signatures processed/yr, we can surmise that it contributed significantly to the total footprint gained.

ii. Based on price paid: 67 clients for $14m spent on ConnectOnCall would imply ~134 clients for the $37m spent on Access eForms = 42 organic adds, down from 136 in 2Q24 and CAC of over $700k. This seems dramatic, but directionally correct.



Note that I am lowballing Access eForms' contribution at +50 clients for the sake of the X-axis. ***It seems entirely possible that organic CAC in 3Q24 was +$500k (2x higher than presented).***

3. **Competition and reduced customer need is weighing on the company's beachhead strategy.** It took Phreesia 15 years to reach 5% share. It then took $300m of losses and 5 years to reach 10%. Beyond dollars spent, the tailwinds of COVID and subdued competition will no longer aid the company in reaching 15%+.

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a. For most of its existence, Phreesia truly offered an unmet need given the lack of an offering by EHR/EMR systems. This was compounded by COVID's wave of adoption for contactless solutions. Going forward, there are several startups founded in the last decade which are now connected to the EMR app marketplaces, offering viable alternatives. But the principal threat will come from the EMRs themselves, as both Epic and Cerner have been making a push a step past simple intake to an all-encompassing patient portal app that offers intake, records, and payment facilitation.

b. The unmet need is no more. One of the main selling points of the software beyond patient experience has been increased collections. Both Epic and Cerner are able to offer these benefits and more. The selling point now is a comparison between a white-labeled app (as I recently was forced to download from NYU's system operated by Epic) vs. a point solution. Additionally, given the value derived in the EMR contract, the big systems are incentivized to take lower margins on ancillary revenue streams like this.

c. Phreesia's payment facilitation margins were +40% between FY19-FY22 but dropped to 36% in FY23 and will end FY24 at 33%, reflecting greater discounts/better terms given to customers to win business. Management mentioned that large customers typically don't add payments functionality at all, so this does likely speak to a greater desperation in driving overall growth than in years prior (rather than trading margin for volume).

Conclusion/Valuation:

In all, Phreesia faces whiplash in the rapidly decelerating pace of true client/network growth, weighing heavily on its most profitable segment, as well as further pressure on the ability to add new clients as competition quietly, but quickly, ramped up during COVID.

A short is timely as FY25 expounds on a more challenging operating environment with tougher comps based on the acquisitions completed throughout FY24. The main catalyst will be the downgrading of out-year revenue growth expectations from the +20%-range for FY26 to low-to-mid teens, based on ad-revenue slowing significantly and higher client acquisition costs. Investors will find that they don't own a SaaS fallen angel, but rather a ~15% topline growth business with its TAM ceiling falling and little profit to show for it. I estimate an optimistic FY29e NOPAT/share of $1.08 which, discounted back, gives a fair value of ~$18/share vs. $26 today.

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Phreesia - PHR	USD
Share Price	$ 26.00
FD Share Count:	55.3
MCap	**1,436.5**
Cash	103.4
Debt	3.7
Enterprise Value	**1,336.8**

FYE Jan 31	FY19	FY20	FY21	FY22	FY23	FY24e	FY25e	FY26e	FY27e	FY28e	FY29e	*Notes*
Payment Revenue	36.9	46.5	49.9	65.2	78.4	94.5	110.4	121.1	129.2	137.0	144.4	
Payment Expense	21.9	27.9	28.9	38.7	50.3	63.3	73.9	81.0	86.5	91.7	96.6	*The company reports payment expense below Gross Profit and considers Total Payment Revenue part of ARR*
Net Payment Revenue	**15.0**	**18.6**	**21.0**	**26.5**	**28.0**	**31.2**	**36.5**	**40.0**	**42.7**	**45.3**	**47.7**	
Growth%		*24%*	*13%*	*26%*	*6%*	*11%*	*17%*	*10%*	*7%*	*6%*	*5%*	
Take%	*41%*	*40%*	*42%*	*41%*	*36%*	*33%*	*33%*	*33%*	*33%*	*33%*	*33%*	*Potential to compress further*
Subscription Revenue	**43.9**	**56.4**	**69.0**	**95.5**	**129.0**	**163.1**	**190.6**	**213.2**	**232.1**	**250.9**	**269.8**	
Growth%		*28%*	*23%*	*38%*	*35%*	*26%*	*17%*	*12%*	*9%*	*8%*	*8%*	
Network (Ad) Revenue	**19.1**	**21.9**	**29.7**	**52.5**	**73.6**	**96.3**	**126.7**	**148.8**	**168.9**	**189.2**	**209.7**	
Growth%		*15%*	*36%*	*77%*	*40%*	*31%*	*31%*	*17%*	*13%*	*12%*	*11%*	
Net Revenue	**78.0**	**96.9**	**119.8**	**174.5**	**230.6**	**290.7**	**353.7**	**402.0**	**443.6**	**485.4**	**527.3**	
Growth%		*24%*	*24%*	*46%*	*32%*	*26%*	*22%*	*14%*	*10%*	*9%*	*9%*	
COGS - SBC	15.1	16.7	22.9	40.6	55.2	61.1	74.3	84.5	93.2	102.0	110.8	
Adj Gross Profit	**62.9**	**80.2**	**96.9**	**133.9**	**175.3**	**229.6**	**279.4**	**317.5**	**350.4**	**383.4**	**416.4**	
Margin%	*81%*	*83%*	*81%*	*77%*	*76%*	*79%*	*79%*	*79%*	*79%*	*79%*	*79%*	
Adj. OPEX (Less SBC)												
S&M	26.1	31.0	39.5	93.9	129.1	121.5	121.5	127.6	134.0	140.7	147.7	*FY25 reset to meet guide, 5% CAGR*
R&D	14.1	17.8	20.6	46.3	79.4	93.3	88.7	93.1	97.7	102.6	107.8	*FY25 reset to meet guide, 5% CAGR*
G&A	19.2	26.6	33.1	53.0	59.2	58.1	52.3	54.9	57.7	60.6	63.6	*FY25 reset to meet guide, 5% CAGR*
Other	2.1	4.3	0.0	0.1	0.2	-	-	-	-	-	-	
Total Adj. OPEX	61.5	79.7	93.2	193.2	267.9	273.0	262.5	275.6	289.4	303.9	319.1	
Other adjustments	2.1	4.3	0.1	0.3	0.2	-	-	-	-	-	-	
Adj EBITDA	**3.5**	**4.8**	**3.8**	**(59.0)**	**(92.3)**	**(43.4)**	**16.9**	**41.9**	**61.0**	**79.5**	**97.4**	
Margin%	*4%*	*5%*	*3%*	*-34%*	*-40%*	*-15%*	*5%*	*10%*	*14%*	*16%*	*18%*	
Capex	4.7	7.0	11.2	18.4	4.7	4.0	4.0	4.0	4.0	4.0	4.0	
Adj EBITDA-Capex	**(1.2)**	**(2.2)**	**(7.4)**	**(77.4)**	**(97.0)**	**(47.4)**	**12.9**	**37.9**	**57.0**	**75.5**	**93.4**	
NOPAT (21% Taxrate)							**10.2**	**29.9**	**45.0**	**59.7**	**73.8**	
NOPAT Per Share							$ 0.17	$ 0.49	$ 0.71	$ 0.90	$ 1.08	
		36.6										
Shares			44.9	52.1	54.2	56.4	58.6	61.0	63.4	65.9	68.6	
Dilution%			*23%*	*16%*	*4%*	*4%*	*4%*	*4%*	*4%*	*4%*	*4%*	

	FY29e
NOPAT/Share	**$ 1.08**
Discount Rate	8%
Time (yrs)	5.0
Discounted NOPAT/Share	**$ 0.73**
Multiple	25.0
Target Value	**$ 18.30**
Downside	*-30%*
Multiple to Justify Current PX	*35.5*

KPIs	FY19	FY20	FY21	FY22	FY23	FY24e	FY25e	FY26e	FY27e	FY28e	FY29e	
EOY AHSC (4Q)	**1,543**	**1,603**	**1,808**	**2,311**	**3,140**	**3,958**	**4,454**	**4,771**	**5,074**	**5,363**	**5,639**	*AHSC = Average Health Service Clients in period*
AHSC (Full year)	**1,490**	**1,571**	**1,711**	**2,074**	**2,856**	**3,600**	**4,206**	**4,613**	**4,923**	**5,218**	**5,501**	
EOY AHSC Growth%		*4%*	*13%*	*28%*	*36%*	*26%*	*13%*	*7%*	*6%*	*6%*	*5%*	
Avg AHSC Growth%		*5%*	*9%*	*21%*	*38%*	*26%*	*17%*	*10%*	*7%*	*6%*	*5%*	
AHSC Adds		***60.0***	***205***	***503***	***829***	***818***	***496***	***317***	***303***	***289***	***276***	
S&M / AHSC Adds		*0.516*	*0.193*	*0.187*	*0.156*	*0.149*	*0.245*	*0.270*	*0.296*	*0.326*	*0.359*	*Mean reversion, competition, less greenfield*
Sub Rev/AHSC (M)	0.029	0.036	0.040	0.046	0.045	0.045	0.045	0.046	0.047	0.048	0.049	*Improving NRR from 95% as cross sell becomes foc*
Net Payment Rev/AHSC (M)	0.010	0.012	0.012	0.013	0.010	0.009	0.009	0.009	0.009	0.009	0.009	*Flat as small client opportunity fades + concessions*
Network Rev/AHSC (M)	0.013	0.014	0.017	0.025	0.026	0.027	0.030	0.032	0.034	0.036	0.038	*Network Growth = AHSC Growth*
Total Revenue	**99.9**	**124.8**	**148.7**	**213.2**	**280.9**	**353.9**	**427.6**	**483.0**	**530.1**	**577.1**	**623.9**	
Growth%		*25%*	*19%*	*43%*	*32%*	*26%*	*21%*	*13%*	*10%*	*9%*	*8%*	
Sellside Consensus Revenue						**354.8**	**429.0**	**509.1**	**587.4**	**677.6**		
Difference$						*(0.9)*	*(1.4)*	*(26.1)*	*(57.3)*	*(100.5)*		
Difference%						*0%*	*0%*	*-5%*	*-10%*	*-15%*		