WESTPEAK
RESEARCH ASSOCIATION

# HMS Holdings Corp. (NASDAQ: HMSY)

**Healthcare Information Technology**

## Health is Wealth

April 8, 2020

*HMS Holdings Corp. ("HMS") is a healthcare information systems company operating in the United States. HMS provides a variety of data analytics and cost containment services for its customers, which include government-sponsored healthcare programs such as Medicare and Medicaid, as well as commercial health plans and private employers. Through its suite of offerings, HMS helps its customers save billions of dollars annually while helping the public lead healthier lives.*

### Thesis

HMS possesses a compelling business strategy, a strong management team, and a solid balance sheet. The company's strategic approach to investments and acquisitions have also positioned it well to pursue both immediate and future growth opportunities. With all this laid out, we believe that the market currently underestimates HMS' ability to remain resilient and competitive during the COVID-19 pandemic and beyond.

### Drivers

We believe that industry tailwinds such as rising healthcare costs and favorable government policy changes will continue to drive growth for HMS, with the industry expected to grow at a CAGR of 13.2% over the next five years. Moreover, recent changes made to HMS' sales personnel are expected to support higher revenue growth in the near future.

### Valuation

Based on our analysis, we arrived a target share price of $36.00, which represents a 34.7% upside to the current share price of $26.73. We determined this figure based on a DCF analysis, both EV/EBITDA exit multiple and perpetuity growth rate, as well as comparable company analysis using PE/EBITDA and EV/EBITDA multiples, all equally weighted at 25%. We initiate a buy rating on HMS Holdings Corp.

**Analyst:** Tiffany Griesbach, BCom. '21
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| Equity Research | US |
|---|---|
| **Price Target** | **USD$ 36.00** |
| **Rating** | Buy |
| **Share Price (Apr. 8 Close)** | USD$ 26.73 |
| **Total Return** | 34.7% |

| Key Statistics | |
|---|---|
| **52 Week H/L** | $40.67/$18.20 |
| **Market Capitalization** | $2.48B |
| **Average Daily Trading Volume** | 0.62M |
| **Net Debt** | $250.14M |
| **Enterprise Value** | $2.73B |
| **Net Debt/EBITDA** | 1.71x |
| **Diluted Shares Outstanding** | 88.4M |
| **Free Float** | 98.4% |
| **Dividend Yield** | - |

**WestPeak's Forecast**

| | 2019A | 2020E | 2021E |
|---|---|---|---|
| **Revenue** | $626M | $714M | $820M |
| **EBITDA** | $146M | $151M | $180M |
| **Net Income** | $87M | $89M | $114M |
| **EPS** | $0.98 | $1.01 | $1.31 |
| **P/E** | 34.0x | 26.5x | 20.6x |
| **EV/EBITDA** | 22.0x | 16.7x | 13.4x |

**1-Year Price Performance**

# Business Overview/Fundamentals

## Company Overview

HMS Holdings Corp. (HMS) is a healthcare information technology holding company based in Irving, Texas. Through its subsidiaries, HMS provides a variety of data analytics and cost management services for its customers, which include government-sponsored healthcare programs in the United States such as Medicare and Medicaid, as well as commercial health plans and private employers. HMS achieves this through its Coordination of Benefits (COB), Payment Integrity (PI), and Population Health Management (PHM) solutions, which together, help its customers save billions of dollars annually while helping the public lead healthier lives.

## Solutions & Services

The Company currently operates as one business segment, but its offerings can be classified under three main categories:

**Coordination of Benefits**

HMS' Coordination of Benefits (COB) primarily serves state governments and Medicaid managed care plans, under multi-year contracts with the option to renew. Medicaid provides health insurance and long-term care services to low-income families and individuals with disabilities in the United States, jointly funded by federal and state governments.

Through employing proprietary information management and data mining techniques, HMS' COB solution helps to ensure that the correct party pays a healthcare claim. When seeking health services, many individuals may have coverage under several different healthcare plans. For example, a person may be eligible to claim insurance benefits under both their employer's group health plan, as well as the state Medicaid plan. By law, the Medicaid program is the payer of last resort. With HMS' COB services providing access to validated insurance information, Medicaid agencies can avoid unnecessary costs by ensuring they pay only after all other insurance coverage available has been exhausted. In cases where Medicaid claims have been paid out incorrectly, COB can also assist in later recovering these payments from the liable third party.

The revenue derived from this segment is largely based on a percentage of some variable consideration, such as number of claims and amount of recoveries or savings, with the remaining being earned as initial contract fees or milestone fees received over the life of the contract as specific performance obligations are met. The COB segment contributed to 64.5% of total revenue in FY19.

**Payment Integrity**

HMS' Payment Integrity (PI) solution is designed to help its customers contain costs by ensuring that healthcare payments are accurate and appropriate. This mainly involves reducing fraud, waste and abuse by identifying and correcting healthcare claims that are billed and paid improperly (e.g. overpayment, double billing). The solution combines data analytics, clinical expertise and proprietary algorithms and technology to proactively review claims on both a pre-payment and post-payment basis.


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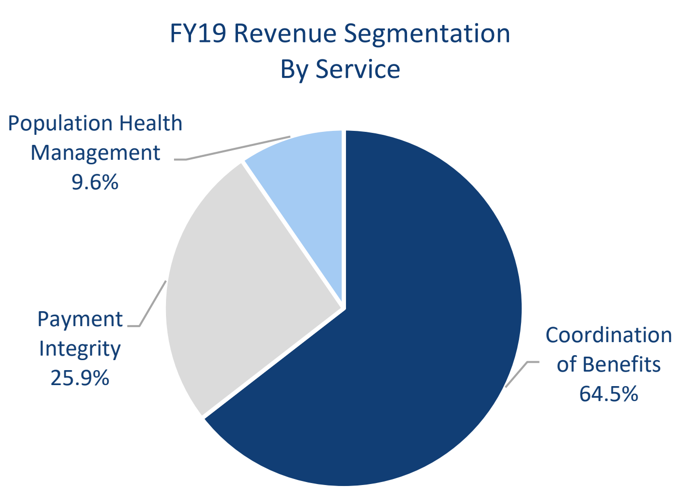
The revenue derived from this segment is largely received based on a percentage of some variable consideration, such as the number of claims or dollar amount of savings or recoveries, with the rest being derived from initial contract fees or fixed-fee arrangements which are paid out over time as specific performance obligations are met. The PI solution offered to all HMS customers, including federal and state governments, commercial health plans, and other at-risk entities such as employers, under multi-year contracts with the option to renew. The revenue from this segment accounted for 25.9% of total revenue in FY19.

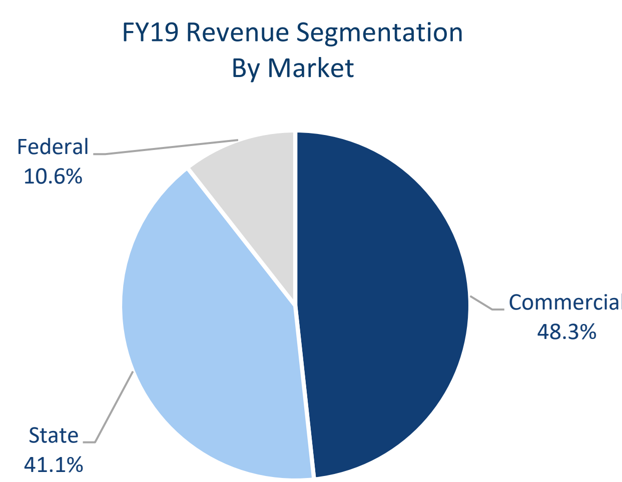
**Population Health Management**

HMS' Population Health Management (PHM) suite of services address costs and improves quality of healthcare, through its offerings of population data and risk analytics (Elli), consumer engagement (Eliza), and care management platforms (Essette). Currently, this service As an effective population health management platform, PHM integrates important components such as early risk identification, multi-channel outreach, social engagement and care and compliance management components. In particular, the platform facilitates secure communication between healthcare providers and patients, and supports features such as automated reminders aimed to increase compliance, engagement, and improve patients' overall quality of life. The PHM solution is both flexible and scalable, providing customers with a tailored, integrated platform in line with their increased focus on consumer engagement and performance management. Over the years, PHM has helped clients reduce enrollment turnover and save billions of dollars through improving the clinical outcomes and overall health of their members.

The revenue from this segment is derived from contracts with health plans and other risk-bearing entities that can last several years with the option to renew. Under the contracts, revenue is largely based on PMPM/PMPY (per member per month/per year) fees, as well as fixed fee arrangements such as initial software and implementation fees. PHM is a relatively new and rapidly growing business, representing 9.6% of HMS' total revenue in FY19.

**Exhibit 1: FY19 Revenue Segmentation**




*Source: Company Filings*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# Company Strategy

## Diversification of Offerings

The company's three distinct business segments enable it to provide a broad range of solutions that span the entire healthcare claims payment and care services continuum. Through ongoing investments in technologies such as artificial intelligence and machine learning, the firm continues to develop new products and enhance existing ones, increasingly becoming a one-stop-shop for healthcare providers and payers. Having a diverse and growing suite of offerings also allow HMS to continuously add value to its clients and meet their evolving needs; strengthening business relationships while creating significant cross-selling opportunities.

## Strategic Acquisitions

Over its many years in business, the company has engaged in several strategic mergers and acquisitions, generating long-term benefits and meaningful synergies. With many past acquisitions now either forming a part of HMS' core business, or representing a complementary subsidiary, management has demonstrated strong forward-looking vision in terms of choosing investments that are in line with the company's long-term strategy. In addition, with a wealth of experience under their belt, management also possesses a strong track record of successfully integrating new businesses with the legacy HMS business.

The company's most recent acquisition is West Claims Recovery Services, LLC (Accent), a payment accuracy and cost containment business from Intrado Corporation. This acquisition represents an enhancement to HMS' existing Payment Integrity solution, providing both immediate market expansion and future growth opportunities. In their most recent quarter earnings call, HMS management reiterated that they will continue to evaluate potential transactions and opportunities that will expand or complement existing offerings. Potential targets would likely provide the company with additional data analytics, algorithmic and financial management capabilities.

**Exhibit 2: Recent Acquisitions Timeline**

| Target | Transaction Size | Date |
|---|---|---|
| (Name) | (USD mm) | mm/dd/yy |
| West Claims Recovery Services, LLC (Accent) | 155.0 | 12/23/19 |
| VitreosHealth, Inc. | 36.5 | 09/16/19 |
| Eliza Corporation | 170.0 | 04/19/17 |
| Essette, Inc. | 21.5 | 09/07/16 |
| HealthDataInsights, Inc. | 366.6 | 12/16/11 |
| Allied Management Group | 26.2 | 07/02/10 |
| Verify Solutions, LLC | 13.6 | 01/04/10 |

*Source: Capital IQ*


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## Strategic Investment in MedAdvisor

In October 2019, HMS made a strategic investment in MedAdvisor (ASX: MDR), an Australian company and industry leader in digital medication management serving pharmacies, doctors, and their patients. Purchasing common shares in the amount of US$7.5 million, HMS now holds a 13% ownership stake of the company and occupies a seat on its board.

This strategic relationship represents an effort to tackle the global issue of medication non-adherence. MedAdvisor's innovative software platform is aimed at helping people manage their healthcare regimen consume their medications on time, safely, and effectively. In essence, a patient's medication and prescription information are organized on their mobile device and is shared with the patient's pharmacy and care provider. The MedAdvisor app reminds patients to take each dose on time and notifies them when it is time to see their doctor or refill their script. In addition to bolstering a major health improvement to patients, this service also benefits doctors, pharmacists and insurance payers.

For HMS, this investment represents a potential expansion to the company's existing Population Health Management capabilities, as well as an opportunity to test the waters in the realm of pharmaceutical management. Additionally, MedAdvisor also possess a fairly established operational footprint in Asia and the UK, primarily through their network of global partners of pharmacies and health providers. In this regard, this strategic relationship also represents a gateway to opportunities for international expansion.

# Industry Analysis

HMS Holdings Corp. operates in the Healthcare Information Technology (HCIT) industry and is the NASDAQ's 4th largest HCIT company by market capitalization. The global HCIT market size was valued at US$125 billion in 2015, and is estimated to reach a whopping US$297 billion by 2022, with a CAGR of 13.2% (Valuates Reports). This rapid growth is mainly driven by increasing healthcare costs, rising enrollment in healthcare plans and programs, as well as payment and process complexities.

## Regulatory Environment

In recent years, the healthcare industry has thrived thanks to favorable legislation and government regulation. For 2020, Medicare and Medicaid are projected to pay approximately 38% of the nation's healthcare expenditures and serve over 146.3 million beneficiaries. In 2019, President Trump issued an executive order pushing the nation's Centers for Medicare & Medicaid Services (CMS) to heighten their focus on program integrity to reduce fraud, waste and abuse in the healthcare insurance market, thereby better protecting taxpayers (WhiteHouse.Gov). In particular, the government has mandated stringent auditing requirements for state healthcare payers under the Recovery Audit Program (RAC), fuelling the demand for services such as HMS' PI and COB offerings.

## Ageing Population

An ageing U.S. population also fuels the need for better, low-cost healthcare. Key to achieving this are technology-driven solutions that increase the efficiency of providing healthcare through reducing human error, enabling processing of large amounts of data, and improving quality of care and patient-provider communication. All this create a favorable environment for healthcare data analytics and management platforms to flourish, such as HMS' PHM business.

## Competition

The market for HCIT is highly competitive, driven by rapid technological innovation, rising industry standards and customer demands for higher efficiency. The industry is relatively fragmented, ranging in size from small, specialized firms to large, diversified companies. New players often emerge out of contractor-subcontractor relationships (the latter seeking to establish direct relationships with the former's customers), and prospective customers may choose to develop the capability to perform certain functions in-house. These factors also drive a fair amount of consolidation within this highly competitive industry, as well as strategic investments and the formation of alliances. In order to remain competitive, industry players may have to be quick and willing to make substantial investments, requiring superior management foresight, strong financial management, and adherence to a compelling long-term strategy.

Overall however, we believe that HMS is well-equipped to stay ahead of its competitors due to its client-centric and value creation approach, impressive cross-selling capabilities, and long-standing relationships with its clients, having retention rates in excess of 96%.


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# Catalysts

## New Sales Team for PHM Business

HMS' Population Health Management (PHM) business is significantly different from the company's other two businesses, and thus requires a different set of skills to sell. While the company's PI and COB solutions are more service-oriented and focused on payment management and systems optimization, PHM's offerings include licensed software that clients can use in-house to manage patient-provider communication and improve health outcomes of their members.

As such, the company began building a dedicated PHM sales team in FY19 and recently completed hiring and training talent, as well as refining its go-to-market strategy. Given that the PHM business is relatively new and offers high-tech capabilities unlike anything the market has seen before, the new sales team is tasked with building an awareness of these capabilities among both new and existing clients. This strategy is already showing signs of success, with two new state contracts signed in Q4. With the installation of the new sales team, we expect PHM sales volume and cross-selling activities to ramp up from FY20 onwards. In particular, as the government procurement process typically requires roughly 12 months to complete, we expect the full benefits of this change to begin materializing in the latter half of FY20.

## Ongoing Transition from MMIS to MES Among State Medicaid Programs

State Medicaid programs have historically relied on large, established Medicaid management information systems (MMIS) to support their core functions. However, over time these solutions have been inflexible and expensive to maintain with long, and sometimes failed, implementations. To address the costs and complexities in maintaining and updating these platforms, the Centers for Medicare and Medicaid Services (CMS) established new guidelines to shift programs towards procuring and building their own Medicaid Enterprise Systems (MES). This new approach focuses on obtaining modular, more flexible solutions, and has led to an increased demand for healthcare IT products and services.

State clients contribute to ~41% of HMS' total revenue, and so we see the increasing adoption of MES as an immediate growth opportunity for HMS across all business segments. As an example, the company recently signed an agreement with the State of New Mexico to manage the quality assurance module of their MES. New Mexico was one of the first states to implement the MES, and we anticipate this to open up new opportunities for HMS with other states.

## COVID-19 Factors – Resilience and Possible Spillover Benefits

Shares of HMS Holdings have performed relatively well even under the economic uncertainty caused by the COVID-19 pandemic. The company's stock price has fallen 3.7% over the past six months, roughly in line with the 3.5% decline in the NASDAQ index. Compared to other sectors, information technology has been largely spared from the worst sentiments of the market, redefining defensive securities in light of the pandemic as seen from the 10.3% decline of the S&P500.

One apparent reason for this resilience is the heightened activity of the healthcare industry especially given the pandemic. The widespread surge of need for COVID-19-related healthcare is expected to significantly boost healthcare expenditure for the foreseeable future, along with the need for solutions such as HMS' products and services. Additionally, we anticipate this higher demand for healthcare to be sustained even as the pandemic subsides, due to the build-up of demand for healthcare procedures and services that are currently suspended or delayed. Overall, we are optimistic about HMS' ability to weather this storm and continue on its strong growth momentum, to possibly an even greater degree than anticipated.


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# Management Team

## Mr. William C. Lucia – President, Chairman, Chief Executive Officer

Mr. William (Bill) Lucia is the President and Chief Executive Officer of HMS Holdings Corp. He assumed the positions in March 2009 and has also been a member of the board since 2008. In July 2015, he was appointed Chairman of the Board. Mr. Lucia joined the company in 1996 and has served in various positions including Chief Operating Officer from 2005 to 2009. Mr. Lucia has more than 20 years of experience in healthcare reimbursement, information systems and large-scale insurance administration. Prior to his time at HMS Holdings, Mr. Lucia served in various executive positions including Senior Vice President, Operations for Celtic Life Insurance Company, and Senior Vice President, Insurance Operations for North American Company for Life and Heath Insurance. Mr. Lucia is a Fellow of Life Management Institute (LOMA).

*Source: Company Website*

Mr. Lucia's total compensation for FY18 was $4.80 million, a figure roughly in line with CEO compensation of similar-sized companies. Out of this, 22% was received as a cash bonus, which we believe is justifiable given the company's reliable performance and continued positive EPS growth (from $0.28 in FY15 to $0.98 in FY19). Furthermore, share-based awards made up 63% of total compensation, which continue to help align his interests with that of the company's shareholders.

## Mr. Douglas M. Williams, Jr. – Executive Vice President and Chief Operating Officer

Mr. Douglas (Doug) Williams, Jr. is the Executive Vice President and Chief Operating Officer of HMS Holdings Corp. He assumed the positions in February 2019 and until then has served in various positions within the company, including President of Markets and Product from January 2015 to December 2016 and Divisional President of Commercial Solutions from December 2013 to January 2015. He has over 25 years of experience in healthcare information technology, sales, and operations, and has served in various executive positions in Aveta, Inc. from 2010 to 2013, and MedeAnalytics from 2006 to 2010 where he was responsible for most the company's activities in North America. Mr. Williams also served as global healthcare partner for IBM, further testifying to his expertise in the industry.

*Source: Company Website*

Mr. Williams' total compensation for FY18 was $2.13 million USD, representing a 10.9% increase from FY17. This breaks down into $1.02mm in cash compensation (48.1% of total) and $1.10mm in equity-based compensation (51.6% of total), which we believe will continue aligning his interests with those of shareholders.

# Capital Structure and Shareholder Base and Liquidity

## Capital Structure

HMS Holdings carries a total debt of $240mm under a revolving credit facility. The Credit Agreement specifies a limit of $500mm and represents a significant source of cash for the company. Advantages to using the credit facility include greater flexibility over the use and repayment of funds as well as its variable interest rates (primarily based on LIBOR), especially given the current environment of falling interest rates.

Overall, the company has a healthy balance sheet with book debt-to-equity ratio of 45.5% (down from 51.1% in FY18), and a 31.3% debt-to-asset ratio (compared to 33.9% in FY18). While some may view that management is underutilizing debt to grow the company, we are satisfied with the company's prudent approach to expansion and the current pace of growth. Furthermore, the company's large cash reserve is sufficient for future investments in R&D and growth through acquisitions.

## Shareholder Base

HMS Holdings currently has 88.4 million shares outstanding with 87.0 million shares (98.4%) in free float, the majority of which are held by institutional investors. Insider ownership is insignificant, with aggregated equity ownership among insiders (management and directors) accounting for 1.66% of outstanding shares. The table below outlines HMS' ten largest shareholders.

**Exhibit 3: Top 10 Largest Shareholders**

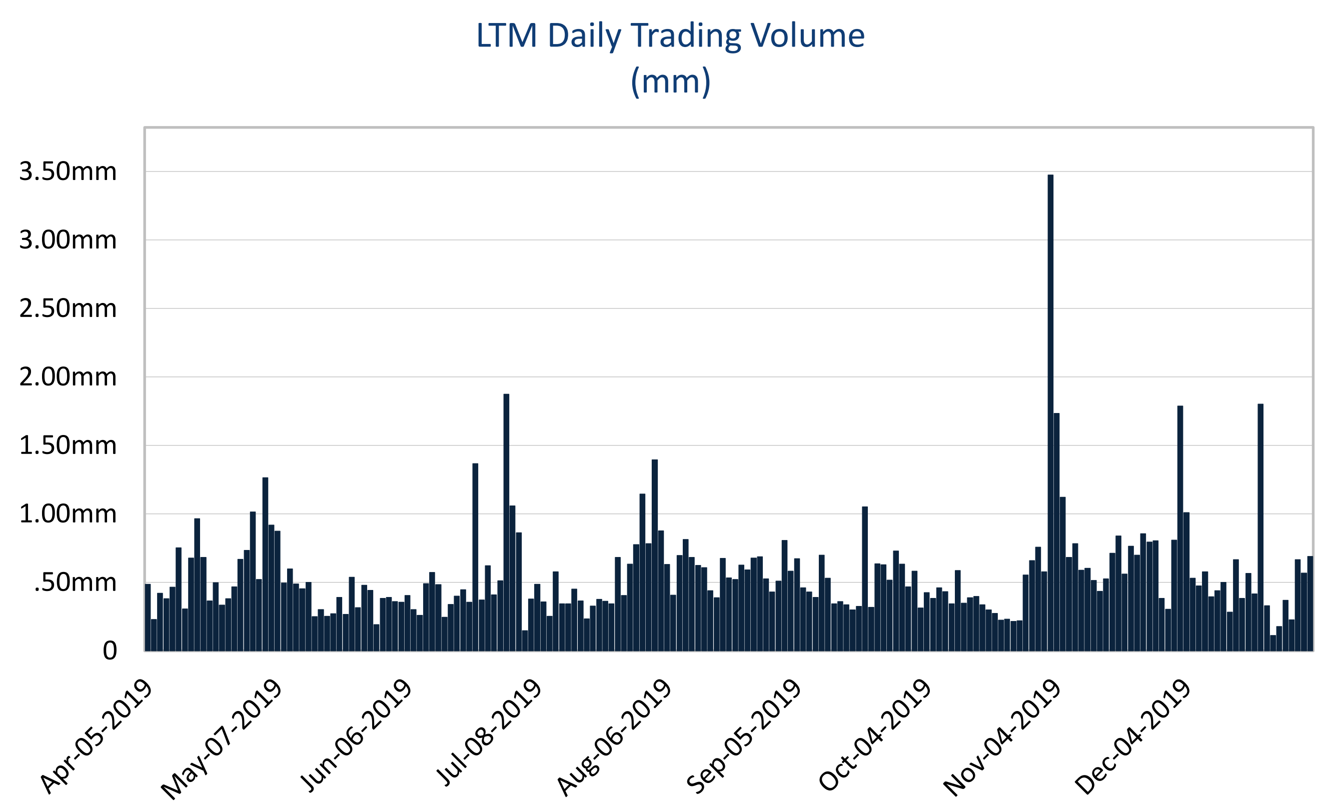
| Shareholder | Shares Owned | Shares Outstanding | Market Value | Insider? |
|---|---|---|---|---|
| (Name) | (Equities) | (%) | (USD mm) | (Yes/No) |
| BlackRock, Inc. | 13,298,468 | 15.10 | 391.8 | No |
| The Vanguard Group, Inc. | 9,458,401 | 10.74 | 278.6 | No |
| Wellington Management Group LLP | 7,497,140 | 8.51 | 220.9 | No |
| T. Rowe Price Group, Inc. | 2,526,528 | 2.87 | 74.4 | No |
| State Street Global Advisors, Inc. | 2,500,420 | 2.84 | 73.7 | No |
| American Capital Management, Inc. | 2,270,552 | 2.58 | 66.9 | No |
| Dimensional Fund Advisors L.P. | 2,184,193 | 2.48 | 64.3 | No |
| Invesco Ltd. | 1,961,130 | 2.23 | 57.8 | No |
| Aristotle Capital Boston, LLC | 1,944,346 | 2.21 | 57.3 | No |
| Van Berkom and Associates Inc. | 1,796,644 | 2.04 | 52.9 | No |
| Top 10 Shareholders | 45,437,822 | 52 | 1,339 | |

*Source: Capital IQ*

## Liquidity

HMS Holdings' daily average trading volume for the last twelve months (LTM) over April 6th 2019 to 2020 is 0.62mm shares per day. This suggests a fairly healthy liquidity for the stock, given its current number of shares outstanding of 88.4mm. Liquidity has also been increasing over time, with average daily share turnover having increased 6.3% over the last five years. The chart below shows the stock's LTM daily trading volume. The spike in trading volume in November 2019 can be attributed to mixed Q3 results, including reporting a total revenue figure lower than that in Q3 of FY18. Finally, we see that the ongoing COVID-19 pandemic has not resulted in any significant changes to liquidity trends.

**Exhibit 4: LTM Daily Trading Volume**




*Source: Capital IQ*

# Valuation

## Discounted Cash Flow Assumptions

**Revenue Forecast**

With a long and visible runway of opportunities ahead, we expect the company's revenue growth to continue. In addition to strong organic growth, we expect managements' approach to acquisitions to continue to bolster revenue growth over time, both from added the revenue streams as well as incremental revenues generated by synergies.

Our near-term forecast for the COB business is primarily based on a conservative take on management's guidance of low single-digit organic growth, coupled with the approximately $50mm of additional inorganic revenue from the Accent acquisition. As well, the unusually low COB revenue in the second half of FY19 was due to lumpiness and timing issues of claim recoveries related to certain clients, and we expect to see this bounce back in the Q1 of FY20, bleeding into Q2 and Q3 as well. This is followed by a fairly consistent CAGR of ~13-15% over the five-year forecast period. This is mostly driven by the growing size of the total addressable market for COB solutions, a robust COB sales queue, and ongoing initiatives in product development (such as real-time insurance identification and eligibility verification solutions), as well as the materialization of synergies from recent acquisitions.

Our optimistic five-year forecast for the PI business (~14-16% CAGR) is supported by the healthcare industry's heightened focus on program and payment integrity, as well as favorable changes in regulation surrounding quality assurance and audit requirements. We also see encouraging trends in new solution adoption within HMS' existing client base for both commercial and government health agencies and programs, which we expect will continue for several years to come.

We also continue to see good momentum in the company's PHM business, with a forecasted 18% growth in FY20 and CAGR (~22-24%) over following next four years. This is driven by several key considerations, namely the ongoing creation of a new and dedicated sales team (which we expect will help speed up the adoption of HMS' high-tech solutions), the ongoing shift from a transactional model to a subscription model, as well as product innovation powered by HMS' strategic partnership with MedAdvisor.

**Cost Assumptions and Margin Analysis**

The higher level of in COGS (or total cost of services) forecasted for FY20 (~67%) is primarily driven by integration costs associated with the Accent acquisition, as well as the ramping up of some costs for IT and operations teams. However, we expect these investments to drive long-term growth and margin improvement, returning to baseline levels of approximately 65% in the long run.

We expect SG&A as a percentage of total revenue to range from ~12% over the forecast period. This figure represents a slight increase over previous years' SG&A margins, primarily driven by marketing activities of new products and services (e.g. aforementioned dedicated sales team for PHM).

In addition, we expect current and future acquisitions to result in negligible impact on margins as target businesses tend to be those with profit margins comparable to that of HMS.

**Capital Expenditures, Depreciation and Amortization**

As the company continues to invest in developing new technologies and grow at a rapid pace, we expect increases in both capital expenditures (capex) and depreciation & amortization (D&A) levels. Accordingly, we estimate capex to be ~10% of beginning PP&E over the forecast period. In our valuation, we added acquisition costs to capex in order to account for the inorganic revenue growth accompanying expansion.

**Income Tax Rate**

We assumed an effective tax rate of 27.8%, a normalized figure based on their most recent annual report. The Company's lower effective tax rate of 16.4% in FY18 was primarily due to favorable tax benefits related to current year credits, equity compensation, a subsidiary basis write off, acquisition adjustments, and other tax considerations. The normalized effective tax rate excludes prior years' expense and benefit adjustments recognized in the respective fiscal year.

**Dividend Policy**

The Company does not expect to pay any cash dividends in the foreseeable future.

**Weighted Average Cost of Capital**

For HMS, we arrived at a Weighted Average Cost of Capital (WACC) of 6.7%. Cost of equity of 7.3% was determined using a risk-free rate of 1.7% (5-Year U.S. Treasury yield pre-COVID-19), an expected market return of 7.2% (5-year annualized return on the S&P500), and a beta of 0.89 (obtained from Bloomberg). We also used a pre-tax cost of debt of 3.5% (from Aswath Damodaran) and the aforementioned effective tax rate of 27.8%.

**Terminal EV/EBITDA Multiple**

Based on our analysis, we went with a 16x terminal EV/EBITDA exit multiple which we believe HMS will hold constant going into perpetuity. We believe this is a reasonable assumption given their strong offerings, solid track record and historically high EV/EBITDA multiples offered to companies in healthcare IT industry.

## Comparable Company Analysis Set

**Computer Programs and Systems, Inc. (NasdaqGS: CPSI)**

Computer Programs and Systems, Inc. is a healthcare information technology company operating in the United States and the Caribbean nation of St. Maarten. Its services and systems offerings include record keeping, patient management and financial accounting software, and its target customers are community hospitals, clinics, nursing homes, assisted living facilities, and small specialty hospitals. The company was founded in 1979 and is headquartered in Mobile, Alabama.

**Inovalon Holdings, Inc. (NasdaqGS: INOV)**

Inovalon Holdings, Inc. is a healthcare technology company. Through its offering of cloud-based tools, platforms, and databases, Inovalon empowers data-driven healthcare in the United States and Puerto Rico. Currently, its platforms contain data from over 964,000 physicians, 519,000 clinical facilities, and approximately 264 million individuals and 42 billion medical events. The company offers real-time data aggregation, analysis and insights, as well as advisory, implementation, and support services to its customers, which include health plans and provider organizations, as well as pharmaceutical, medical device, and diagnostics companies. The company was founded in 1998 and is headquartered in Bowie, Maryland.

**Cerner Corporation (NasdaqGS: CERN)**

Cerner Corporation is an American company and global supplier of health information technology (HIT) solutions, services, devices, and hardware. Cerner's software empowers the systems, storage and management of patients' electronic health records (EHRs), and facilitates connectivity of those records to medical devices. The software also facilitates patient data sharing and coordination among departments, physicians, nurses, laboratory technicians, pharmacists, front- and back-office professionals, and consumers. Other tech-enabled services provided include transaction processing, operation and financial management services, implementation and training, support and maintenance, and employee wellness programs. The company serves a diverse and substantial customer base, which include hospitals, blood banks, medical centers, laboratories, imaging centers, pharmacies, pharmaceutical manufacturers, employers, governments and public health organizations. As of February 2018, its products were in use at more than 27,000 facilities around the world. Cerner Corporation was founded in 1979 and is headquartered in North Kansas City, Missouri.

**Evolent Health (NYSE: EVH)**

Evolent Health, Inc. is a healthcare technology company engaged in healthcare delivery and payment solutions in the United States. The company's Services segment provides a variety of tools which facilitate health data analytics, patient engagement, workflow management, and revenue and cost management solutions. The company's True Health segment operates a commercial health plan for small and large businesses in New Mexico. Evolent Health, Inc. was founded in 2011 and is headquartered in Arlington, Virginia.

**DXC Technology Company**

DXC Technology is an American multinational corporation that provides business-to-business (B2B) information technology services. The company's Global Business Services (GBS) segment offers technology solutions comprising of enterprise, consulting, analytics and business process services, as well as industry software and solutions, among others. The Global Infrastructure Services (GIS) segment provides cloud and platform services pertinent to workplace, mobility, the Internet of Things (IoT), and security. DXC Technology was founded in 2017 as the result of the spin-off of a segment of Hewlett Packard Enterprise and is headquartered in Tysons, Virginia.

**Tabula Rasa HealthCare, Inc. (NasdaqGM: TRHC)**

Tabula Rasa HealthCare, Inc. is a healthcare technology company operating in the field of medication safety in the United States. Using patient-specific and data-driven technology and solutions, the company enables physicians, pharmacists and healthcare organizations to optimize medication regimens, effectively managing medication risk, improve patient outcomes and lower healthcare costs. Tabula Rasa also offers a variety of cloud-based services pertaining to pharmacy inventory management, patient management, cost management and health plan management, among others. The company was founded in 2009 and is headquartered in Moorestown, New Jersey.

**Performant Financial Corporation (NasdaqGM: TRHC)**

Performant Financial Corporation is an information technology services company that provides payment recovery and related analytics services in the United States. The company serves governments and private clients to identify and recover delinquent, defaulted and improper payments, especially with regards to student loans, healthcare payments and taxes. Performant Financial Corporation was founded in 1976 and is headquartered in Livermore, California.

## Weighted Price Target

Our final valuation is computed using all of the methods mentioned above (DCF with perpetuity growth 3.0%, DCF with exit multiple 16.0x, CCA with mean EV/EBITDA 20.8x, and CCA with mean P/E 32.0x) each equally weighted at 25%. Our perpetuity growth and exit multiple DCF analyses yielded an implied share price of $39.07 and $38.79 respectively, while our comparable companies analyses on an EV/EBITDA and P/E basis yielded an implied share price of $34.20 and $31.69 respectively. Taking the average of these values, we arrived at a target share price of $36.00, which represents a 34.7% upside to its current share price of $26.73.

# Recommendation

## Buy

Based on our analysis, we believe that shares of HMS are currently undervalued by the market, providing a significant opportunity for investors to purchase the stock at a discount. The company is headed by a strong management team with a solid track record of making investment decisions with high ROIC, as well as possesses a compelling business strategy, high quality earnings, and a flawless balance sheet. In addition, we view the company's prospects and pipeline of opportunities as a solid foundation and runway for growth, and anticipate the benefits from recent investments in sales staffing to materialize in the year. The current regulatory environment is also very conducive to HMS' growth, and this coupled with the company's resilience in light of the COVID-19 pandemic, makes HMS stock a safe and promising investment during these uncertain times.

Based on our DCF model and comparable company analysis, we determined a fair share price of $36.00, representing an implied upside of 34.7% to its current share price. Hence, we initiate a buy rating on HMS Holdings Corp.

# Risks

## Concentrated Customer Base

HMS generates a significant portion of revenues from a limited number of large customers at the federal and state level. Due to the flexible nature of contracts with those entities, which require periodic renewal and allow for unconditional termination on short notice, maintaining a high level of customer retention is crucial. If a customer is unsatisfied with the quality of the services provided, they may seek to reduce the scope of or end their agreement with the company. Such actions by a customer may cause HMS to incur or absorb additional costs, as well as damage the company's ability to win future business from that customer, or other current or prospective customers. The customer may then choose to insource services, or worse, give their business over to a competitor. Failure to retain customers may thus result in a material adverse impact to the company's financial performance and future growth prospects.

## Unfavorable Outcomes in Legal Proceedings

Unfavorable outcomes in legal proceedings pose a significant risk to the company. Due to the nature of their business, the company may be involved in legal proceedings from time-to-time, often in cases with regard to claims disputes, contractual disputes, privacy and confidentiality issues, as well as compliance with state and federal statutes. In addition to high litigation costs and settlement expenses, HMS may also suffer an adverse impact to their reputation in the industry. This then may compromise the company's ability to win future contracts, resulting in material negative effects on the company's operations, cash flows and financial condition.

## 2020 U.S. Presidential Election

The upcoming 2020 US Presidential Election is also an important factor to consider, the results of which may influence the way healthcare is administered and paid for. Republicans generally favors market-based solutions over government intervention. Having historically supported repealing the Affordable Care Act (ACA), which would include halting Medicaid expansion, a Republican Party victory would most likely result in slower growth in government expenditure on healthcare. On the other hand, a Democratic victory would most likely lead to more healthcare reforms which include retaining, improving and expanding the ACA. With the recent end to Sen. Sanders' campaign leaving Vice President Joe Biden as the apparent Democratic nominee, his plans to create an optional government insurance plan (commonly known as the public option) and inject more federal subsidies into the state exchanges set up under the Affordable Care Act, may soon become reality. Either way, we see the upcoming election as offering little or no downside to HMS and the industry under any scenario, and a myriad of potential benefits in a Democratic win scenario. Furthermore, as the client base of HMS is fairly diversified (encompassing private, commercial and government insurance plans), the question of who pays for healthcare poses a limited risk to the company.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# Appendix 1: Model Summary

| | *Dec-14* | *Dec-15* | *Dec-16* | *Dec-17* | *Dec-18* | *Dec-19* | *Dec-20* | *Dec-21* | *Dec-22* | *Dec-23* | *Dec-24* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *(Figures in mm USD)* | **FY2014** | **FY2015** | **FY2016** | **FY2017** | **FY2018** | **FY2019** | **FY2020** | **FY2021** | **FY2022** | **FY2023** | **FY2024** |
| **Income Statement** | | | | | | | | | | | |
| **Revenue** | 443.2 | 474.2 | 489.7 | 521.2 | 598.3 | 626.4 | 714.0 | 819.8 | 946.8 | 1,092.0 | 1,258.0 |
| **EBITDA** | 87.8 | 98.2 | 102.7 | 100.5 | 120.8 | 146.0 | 151.0 | 180.4 | 217.8 | 251.2 | 289.3 |
| **Net Income** | 13.9 | 24.5 | 37.6 | 40.1 | 55.0 | 87.2 | 88.8 | 114.1 | 144.9 | 171.9 | 201.6 |
| **Earnings Per Share** | $ 0.16 | $ 0.28 | $ 0.43 | $ 0.47 | $ 0.64 | $ 0.98 | $ 1.01 | $ 1.30 | $ 1.65 | $ 1.95 | $ 2.29 |
| **Cash Flow Statement** | | | | | | | | | | | |
| **Capital Expenditures (non-acquisitions)** | (26.2) | (11.8) | (21.0) | (33.0) | (30.4) | (21.6) | - | - | - | - | - |
| **Acquisitions** | - | - | (20.7) | (171.3) | - | (185.8) | (7.9) | (6.7) | (5.1) | (3.9) | (3.0) |
| **Divestitures** | - | - | 2.5 | - | - | 9.8 | - | - | - | - | - |
| **Balance Sheet** | | | | | | | | | | | |
| Current Assets | 317.6 | 329.1 | 367.6 | 292.7 | 425.3 | 397.4 | 501.6 | 641.1 | 810.8 | 1,007.5 | 1,240.2 |
| Non-Current Assets | 563.4 | 521.5 | 515.1 | 682.5 | 653.2 | 846.9 | 826.8 | 811.2 | 799.2 | 790.1 | 783.0 |
| **Assets** | 881.0 | 850.6 | 882.8 | 975.2 | 1,078.5 | 1,244.3 | 1,328.5 | 1,452.3 | 1,610.0 | 1,797.5 | 2,023.2 |
| Current Liabilities | 91.3 | 88.6 | 90.2 | 92.7 | 96.6 | 101.3 | 96.7 | 106.4 | 119.3 | 134.9 | 158.9 |
| Non-Current Liabilities | 256.6 | 237.3 | 236.0 | 276.2 | 268.5 | 288.1 | 288.1 | 288.1 | 288.1 | 288.1 | 288.1 |
| **Liabilities** | 347.9 | 325.9 | 326.1 | 368.9 | 365.1 | 389.4 | 384.8 | 394.5 | 407.4 | 423.0 | 447.0 |
| **Shareholders' Equity** | 533.1 | 524.7 | 556.6 | 606.2 | 713.4 | 854.9 | 943.7 | 1,057.8 | 1,202.7 | 1,374.6 | 1,576.2 |
| **Cash** | 133.1 | 145.6 | 176.0 | 83.3 | 178.9 | 139.3 | 222.4 | 323.1 | 438.7 | 577.5 | 743.8 |
| **Debt** | 347.9 | 325.9 | 326.1 | 368.9 | 365.1 | 389.4 | 384.8 | 394.5 | 407.4 | 423.0 | 447.0 |
| **Net Debt** | 214.8 | 180.3 | 150.1 | 285.6 | 186.2 | 250.1 | 162.4 | 71.4 | (31.4) | (154.5) | (296.8) |
| **Minority Interests** | - | - | - | - | - | - | - | - | - | - | - |
| **Debt/EBITDA** | 2.4 x | 1.8 x | 1.5 x | 2.8 x | 1.5 x | 1.7 x | 1.1 x | 0.4 x | n/a | n/a | n/a |
| **Operating Metrics** | | | | | | | | | | | |
| **Return on Equity (ROE)** | 2.6% | 4.7% | 6.8% | 6.6% | 7.7% | 10.2% | 9.4% | 10.8% | 12.0% | 12.5% | 12.8% |
| **Return on Assets (ROA)** | 1.6% | 2.9% | 4.3% | 4.1% | 5.1% | 7.0% | 6.7% | 7.9% | 9.0% | 9.6% | 10.0% |
| **Return on Invested Capital (ROIC)** | 2.4% | 4.2% | 6.2% | 5.7% | 7.3% | 7.8% | 8.0% | 10.1% | 12.4% | 14.1% | 15.8% |
| **Valuation Metrics** | | | | | | | | | | | |
| Stock Price (High) | $ 31.93 | $ 23.23 | $ 19.10 | $ 23.46 | $ 20.90 | $ 39.93 | $ 26.73 | $ 26.73 | $ 26.73 | $ 26.73 | $ 26.73 |
| Stock Price (Low) | $ 17.39 | $ 15.74 | $ 8.24 | $ 16.18 | $ 11.01 | $ 26.53 | $ 26.73 | $ 26.73 | $ 26.73 | $ 26.73 | $ 26.73 |
| Stock Price (Average) | $ 24.66 | $ 19.49 | $ 13.67 | $ 19.82 | $ 15.96 | $ 33.23 | $ 26.73 | $ 26.73 | $ 26.73 | $ 26.73 | $ 26.73 |
| Diluted Shares Outstanding (Average) | 88.2 | 88.4 | 87.0 | 85.1 | 86.1 | 89.3 | 88.0 | 88.0 | 88.0 | 88.0 | 88.0 |
| Market Capitalization (Average) | 2,174.1 | 1,721.7 | 1,189.1 | 1,686.4 | 1,374.4 | 2,968.0 | 2,351.9 | 2,351.9 | 2,351.9 | 2,351.9 | 2,351.9 |
| Enterprise Value (Average) | 2,388.9 | 1,902.0 | 1,339.3 | 1,972.1 | 1,560.6 | 3,218.1 | 2,514.3 | 2,423.3 | 2,320.5 | 2,197.4 | 2,055.1 |
| **P/E** | 155.9 x | 70.2 x | 31.6 x | 42.1 x | 25.0 x | 34.0 x | 26.5 x | 20.6 x | 16.2 x | 13.7 x | 11.7 x |
| **EV/EBITDA** | 27.2 x | 19.4 x | 13.0 x | 19.6 x | 12.9 x | 22.0 x | 16.7 x | 13.4 x | 10.7 x | 8.7 x | 7.1 x |
| **FCF Yield to Market Capitalization** | 3.7% | 3.8% | 4.0% | -6.6% | 4.8% | -3.5% | 3.5% | 4.3% | 4.9% | 5.9% | 7.1% |
| **FCF Yield to Enterprise Value** | 3.3% | 3.5% | 3.6% | -5.6% | 4.2% | -3.2% | 3.3% | 4.2% | 5.0% | 6.3% | 8.1% |
| **Free Cash Flow** | | | | | | | | | | | |
| EBIT | 34.2 | 47.6 | 57.7 | 50.4 | 63.2 | 103.0 | 123.0 | 158.1 | 200.7 | 238.1 | 279.3 |
| Tax Expense | (12.4) | (15.3) | (11.8) | 0.2 | 2.0 | (28.6) | (34.2) | (43.9) | (55.8) | (66.2) | (77.6) |
| D&A | 53.6 | 50.6 | 45.0 | 50.1 | 57.6 | 43.0 | 28.0 | 22.3 | 17.1 | 13.1 | 10.0 |
| Capital Expenditures | (26.2) | (11.8) | (41.7) | (204.4) | (30.4) | (207.4) | (7.9) | (6.7) | (5.1) | (3.9) | (3.0) |
| Changes in NWC | 30.2 | (5.3) | (1.1) | (7.0) | (26.2) | (12.7) | (25.8) | (29.0) | (41.2) | (42.3) | (42.4) |
| **Unlevered Free Cash Flow** | 79.4 | 65.8 | 48.1 | (110.7) | 66.2 | (102.7) | 83.1 | 100.7 | 115.7 | 138.8 | 166.3 |

**Valuation Summary**

| | |
|---|---|
| **Current Price** | **$ 26.73** |
| Target Price | $ 35.94 |
| Total Return | 34.4% |
| **Recommendation** | **BUY** |

| | |
|---|---|
| **DCF Valuation** | |
| Perpetuity Growth Implied Price | $ 39.07 |
| Exit Multiple Implied Price | $ 38.79 |
| **Comps Valuation** | |
| Comps - EV/EBITDA Implied Price | $ 34.20 |
| Comps - P/E Implied Price | $ 31.69 |

# Appendix 2: Discounted Cash Flow Analysis

| (Figures in mm USD) | Dec-14 FY2014 | Dec-15 FY2015 | Dec-16 FY2016 | Dec-17 FY2017 | Dec-18 FY2018 | Mar-19 Q1-2019 | Jun-19 Q2-2019 | Sep-19 Q3-2019 | Dec-19 Q4-2019 | Dec-19 FY2019 | Dec-20 FY2020 | Dec-21 FY2021 | Dec-22 FY2022 | Dec-23 FY2023 | Dec-24 FY2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Free Cash Flow** | | | | | | | | | | | | | | | |
| EBIT | 34.2 | 47.6 | 57.7 | 50.4 | 63.2 | 19.7 | 40.5 | 17.1 | 25.7 | 103.0 | 123.0 | 158.1 | 200.7 | 238.1 | 279.3 |
| Less: Tax expense | (12.4) | (15.3) | (11.8) | 0.2 | 2.0 | (5.5) | (11.3) | (4.7) | (7.1) | (28.6) | (34.2) | (43.9) | (55.8) | (66.2) | (77.6) |
| Add: Depreciation and amortization | 53.6 | 50.6 | 45.0 | 50.1 | 57.6 | 10.3 | 10.4 | 11.1 | 11.3 | 43.0 | 28.0 | 22.3 | 17.1 | 13.1 | 10.0 |
| Less: Capital expenditures (incl. acquisitions) | (26.2) | (11.8) | (41.7) | (204.4) | (30.4) | (4.0) | (4.4) | (44.7) | (154.3) | (207.4) | (7.9) | (6.7) | (5.1) | (3.9) | (3.0) |
| Less: Change in net working capital | 30.2 | (5.3) | (1.1) | (7.0) | (26.2) | (14.9) | 11.1 | 4.9 | (13.8) | (12.7) | (25.8) | (29.0) | (41.2) | (42.3) | (42.4) |
| **Unlevered Free Cash Flow** | **79.4** | **65.8** | **48.1** | **(110.7)** | **66.2** | **5.6** | **46.4** | **(16.5)** | **(138.2)** | **(102.7)** | **83.1** | **100.7** | **115.7** | **138.8** | **166.3** |
| Discount factor | | | | | | 0.25 | 0.50 | 0.75 | 1.00 | 1.00 | 2.00 | 3.00 | 4.00 | 5.00 | 6.00 |
| **Present Value of Unlevered Free Cash Flow** | | | | | | **5.5** | **44.9** | **(15.7)** | **(129.6)** | **(94.9)** | **74.9** | **83.0** | **89.3** | **100.5** | **112.9** |

**WACC Calculations**

| Cost of Equity | |
|---|---|
| Risk-free rate | 1.7% |
| Expected market return | 8.0% |
| **Market Risk Premium** | **6.3%** |
| Beta | 0.89 |
| **Cost of Equity** | **7.3%** |

| Cost of Debt | |
|---|---|
| Pre-tax cost of debt | 3.5% |
| Effective tax rate | 27.8% |
| **Cost of Debt** | **2.5%** |

| WACC | |
|---|---|
| Market value of equity | 2,360.9 |
| Market value of debt | 362.9 |
| **Total Capitalization** | **2,723.8** |
| Cost of equity | 7.3% |
| Cost of debt | 2.5% |
| **WACC** | **6.7%** |

**Discounted Cash Flow Valuations**

| Perpetuity Growth Method | |
|---|---|
| **Perpetuity Growth Rate** | 3.0% |
| PV sum of unlevered FCF | 365.7 |
| Terminal value | 3,167.1 |
| **Enterprise Value** | **3,532.8** |
| Add: Cash | 280.6 |
| Less: Debt | 362.9 |
| Less: Other EV adjustments | - |
| **Equity Value** | **3,450.5** |
| Shares outstanding | 88.3 |
| **Implied Share Price** | **$ 39.07** |
| Current Price | $ 26.73 |
| **Implied Price** | **$ 39.07** |
| **Total Return** | **46.2%** |

| Exit Multiple Method | |
|---|---|
| **Terminal EV/EBITDA Multiple** | 16.0 x |
| PV sum of unlevered FCF | 365.7 |
| Terminal value | 3,142.3 |
| **Enterprise Value** | **3,508.0** |
| Add: Cash | 280.6 |
| Less: Debt | 362.9 |
| Less: Other EV adjustments | - |
| **Equity Value** | **3,425.7** |
| Shares outstanding | 88.3 |
| **Implied Share Price** | **$ 38.79** |
| Current Price | $ 26.73 |
| **Implied Price** | **$ 38.79** |
| **Total Return** | **45.1%** |

| Perpetuity Growth Rate \ WACC | 7.70% | 7.20% | 6.70% | 6.20% | 5.70% |
|---|---|---|---|---|---|
| 2.00% | $ 24.61 | $ 27.45 | $ 30.89 | $ 35.17 | $ 40.62 |
| 2.50% | $ 26.80 | $ 30.17 | $ 34.34 | $ 39.66 | $ 46.64 |
| 3.00% | $ 29.46 | $ 33.54 | $ 38.72 | $ 45.54 | $ 54.90 |
| 3.50% | $ 32.75 | $ 37.82 | $ 44.47 | $ 53.61 | $ 66.92 |
| 4.00% | $ 36.93 | $ 43.43 | $ 52.35 | $ 65.34 | $ 85.99 |

| Terminal EV/EBITDA Multiple \ WACC | 7.70% | 7.20% | 6.70% | 6.20% | 5.70% |
|---|---|---|---|---|---|
| 14.0 x | $ 32.41 | $ 33.33 | $ 34.28 | $ 35.27 | $ 36.28 |
| 15.0 x | $ 34.51 | $ 35.49 | $ 36.50 | $ 37.55 | $ 38.63 |
| 16.0 x | $ 36.60 | $ 37.65 | $ 38.72 | $ 39.83 | $ 40.98 |
| 17.0 x | $ 38.70 | $ 39.81 | $ 40.94 | $ 42.12 | $ 43.33 |
| 18.0 x | $ 40.80 | $ 41.96 | $ 43.16 | $ 44.40 | $ 45.68 |


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# Appendix 3: Comparable Company Analysis

*(Figures in mm USD)*

| Company | Ticker | Equity Value | Enterprise Value | EV/EBITDA Multiple: 2018A EV/EBITDA | 2019E EV/EBITDA | 2020E EV/EBITDA | P/E Multiple: 2018A P/E | 2019E P/E | 2020E P/E |
|---|---|---|---|---|---|---|---|---|---|
| Computer Programs & | (NasdaqGS: CPSI) | 380.3 | 505.3 | 13.8 x | 13.5 x | 14.4 x | - | 21.9 x | 27.0 x |
| Inovalon Holdings | (NasdaqGS: INOV) | 3,035.2 | 3,962.9 | 44.6 x | 40.6 x | 24.0 x | - | 37.7 x | 33.1 x |
| Cerner Corporation | (NasdaqGS: CERN) | 23,190.0 | 23,729.1 | 16.7 x | 15.4 x | 18.8 x | 47.3 x | 27.7 x | 23.5 x |
| Evolent Health | (NYSE: EVH) | 751.7 | 939.3 | - | - | 24.6 x | - | - | - |
| DXC Technology Com | (NYSE: DXC) | 9,018.9 | 16,615.9 | 4.4 x | 4.3 x | 3.5 x | 5.8 x | 7.9 x | - |
| Tabula Rasa Healthca | (NasdaqGM: TRHC) | 981.5 | 1,183.2 | 72.6 x | 32.5 x | 23.8 x | - | 67.2 x | 50.0 x |
| Performant Financial C | (NasdaqGS: PFMT) | 59.8 | 124.6 | 9.0 x | - | 8.5 x | - | - | - |
| **HMS Holdings Corp.** | **(XCH: TCK)** | **2,360.9** | **2,443.2** | **20.2 x** | **16.7 x** | **16.2 x** | **41.9 x** | **27.4 x** | **26.5 x** |
| **Median** | | | | | **13.5 x** | **18.8 x** | | **21.9 x** | **23.5 x** |
| **Mean** | | | | | **21.3 x** | **16.8 x** | | **32.5 x** | **33.4 x** |
| **High** | | | | | **40.6 x** | **24.6 x** | | **67.2 x** | **50.0 x** |
| **Low** | | | | | **4.3 x** | **3.5 x** | | **7.9 x** | **23.5 x** |

| | EV/EBITDA Implied Price | | P/E Implied Price | |
|---|---|---|---|---|
| Median | $ 21.34 | $ 31.27 | $ 21.36 | $ 23.73 |
| **Mean** | **$ 34.20** | **$ 27.83** | **$ 31.69** | **$ 33.74** |
| High | $ 66.21 | $ 41.17 | $ 65.61 | $ 50.50 |
| Low | $ 6.12 | $ 5.05 | $ 7.70 | $ 23.73 |

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