

December 4, 2018

HealthEquity: (HQY)

Eric Munn

Sector: Healthcare

Industry: Healthcare Equipment and Services

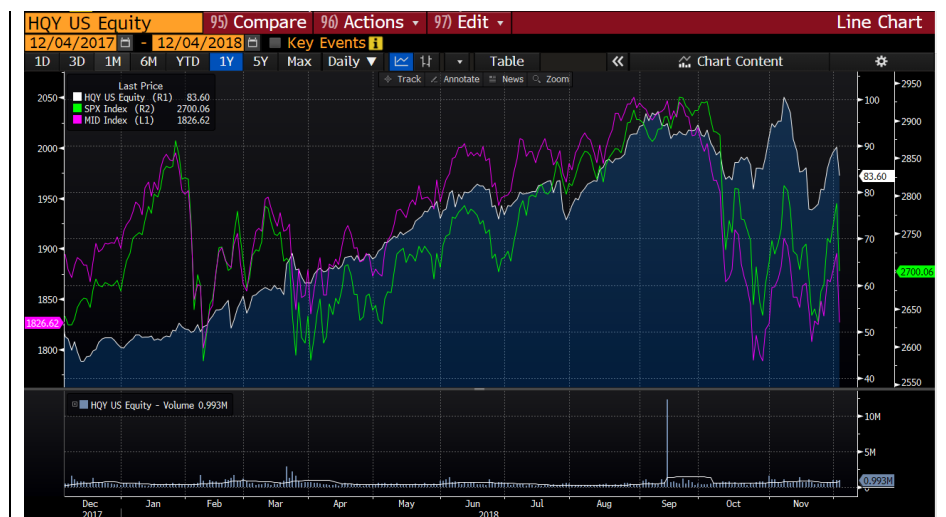
Current Price: \$83.60

Target Price: \$119.15

HealthEquity is a cloud based solution for tax-advantaged HSAs, comparing treatment options and pricing, evaluating and paying healthcare bills, receiving personalized benefit and clinical information, earning wellness incentives, and making educated investment choices to grow tax-advantaged healthcare savings.

BUY

Current Price:	\$83.60
Target Price:	\$119.15
Market Cap:	5B
NI Margin:	19.5%
ROE:	16.86
Kd:	3%
WACC:	8.74
SI Ratio:	4.99
Avg. Volume:	641k



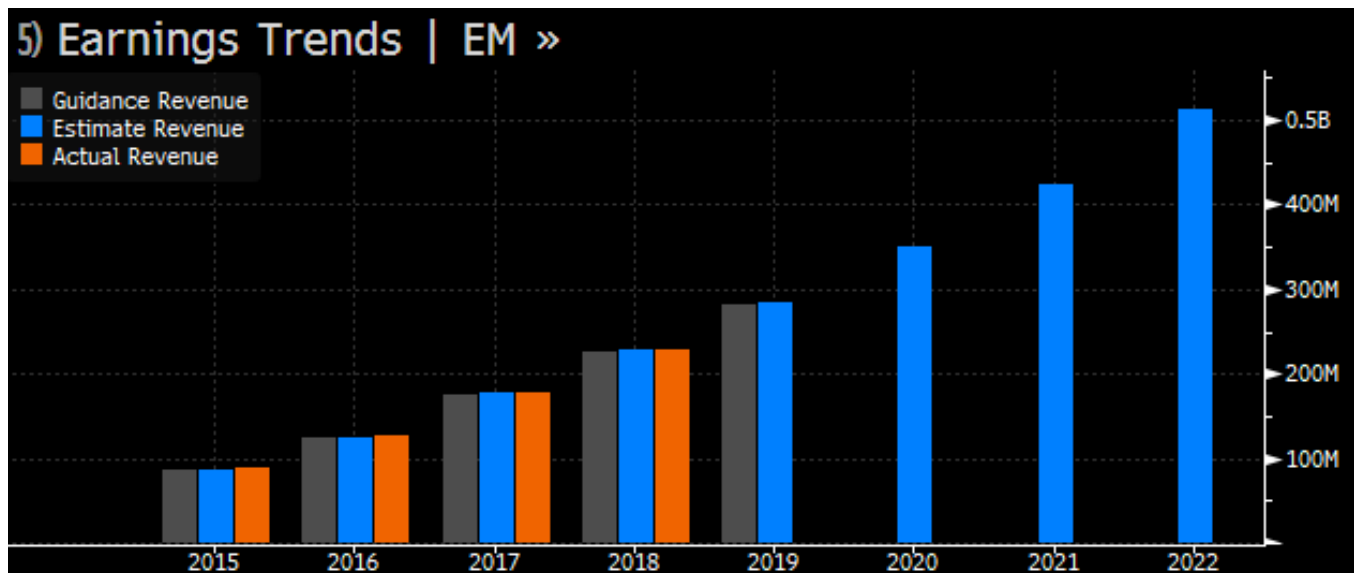
Thesis: HQY was a victim of the recent sell off and has already started to rebound. The HSA market will continue to grow at a rapid pace, and HQY is poised to take advantage. Recent legislation that will expand HAS use, have passed through the house and should pass through the senate. Recent and future interest rate hikes will have a positive long-term effect on custodial revenue streams.

Catalysts:

- Short Term: **Market Correction Rebound**
- Mid Term: **Changes in Legislation**
- Long Term: **Interest Rate Hikes**

Earnings Performance:

HealthEquity has proven its capacity to generate revenue and in the past, with continual increases in margin. The growth should continue, based on the factors discussed below.



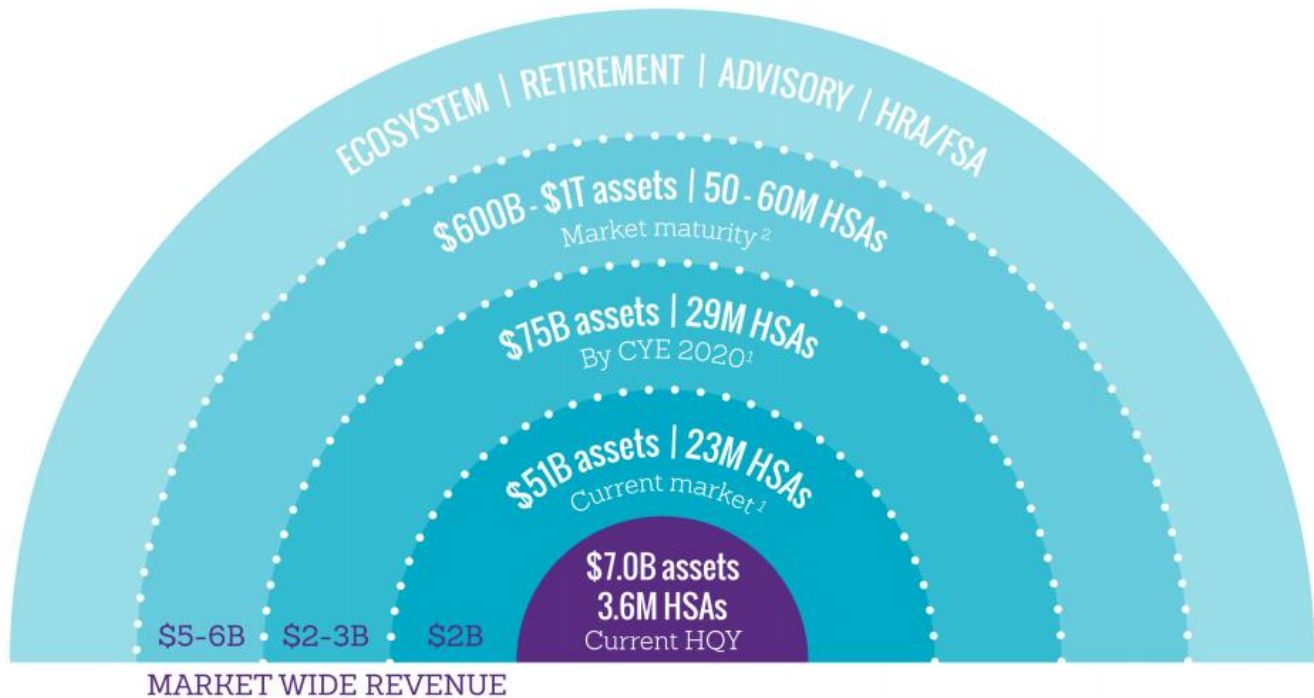
1) Key Stats	2) I/S	3) B/S	4) C/F	5) Ratios	6) Segments	7) Addl	8) ESG	9) Custom	
11) Adj Highlights	12) GAAP Highlights	13) Earnings	14) Enterprise Value	15) Multiples	16) Per Share	17) Stock			
In Millions of USD	2013 Y	2014 Y	2015 Y	2016 Y	2017 Y	2018 Y	Current/LTM	2019 Y Est	2020 Y Est
12 Months Ending	01/31/2013	01/31/2014	01/31/2015	01/31/2016	01/31/2017	01/31/2018	10/31/2018	01/31/2019	01/31/2020
Market Capitalization	—	—	1,138.2	1,244.0	2,753.6	3,079.0	5,215.0		
- Cash & Equivalents	5.9	13.9	111.0	123.8	180.4	240.3	330.3		
+ Preferred & Other	55.5	55.9	0.0	0.0	0.0	0.0	0.0		
+ Total Debt	2.1	0.0	0.0	0.0	0.0	0.0	0.0		
Enterprise Value	—	—	1,027.2	1,120.2	2,573.3	2,838.7	4,884.7		
Revenue, Adj	46.1	62.0	87.9	126.8	178.4	229.5	271.9	283.9	349.4
Growth %, YoY	—	34.6	41.7	44.3	40.7	28.7	25.9	23.7	23.1
Gross Profit, Adj	24.1	32.8	48.0	72.6	106.4	134.9	168.4	174.2	219.6
Margin %	52.3	52.9	54.6	57.3	59.6	58.8	61.9	61.4	62.9
EBITDA, Adj	10.5	15.8	22.8	35.2	55.0	72.6	91.0	112.2	143.5
Margin %	22.7	25.5	25.9	27.8	30.9	31.6	33.5	39.5	41.1
Net Income, Adj	4.0	-7.1	12.1	16.9	26.8	34.8	53.0	71.0	93.9
Margin %	8.7	-11.5	13.7	13.3	15.0	15.2	19.5	25.0	26.9
EPS, Adj	0.25	-1.26	0.21	0.29	0.45	0.57	0.84	1.12	1.38
Growth %, YoY	—	—	—	35.8	56.7	26.9	37.0	96.8	23.9
Cash from Operations	11.8	18.0	15.0	26.5	45.6	81.7	100.6		
Capital Expenditures	-0.8	-1.6	-1.7	-2.4	-3.6	-5.5	-5.5	-15.5	-19.0
Free Cash Flow	10.9	16.4	13.3	24.2	41.9	76.2	95.1	72.1	92.5

HSA Growth:

According to the CMS Nation Health Expenditure Projections 2017-2016, “Under current law, national health spending is projected to grow at an average rate of 5.5 percent per year for 2017-26 and to reach \$5.7 trillion by 2026. The need for out-of-pocket expenses will grow along with it. HSA assets exceed 50B. Assets will likely grow to around 75B by 2020.

HealthEquity is poised to continue to take advantage of the expanding potential consumers with their focus on innovative and full service capabilities in the HSA space. They have successfully defended their leadership position in the market as third largest HSA custodian. According to the 2017 Devenir HSA research report, their market share has nearly tripled from 4% in December of 2010 to 13% as of December 2017.

They believe the healthcare cost shift to consumers will cause the 190 million under-65 consumers that have private health insurance to use products like theirs. This is evidence by the YoY increases in HSA members we keep seeing.



HSA Members (unaudited)

(in thousands, except percentages)	October 31, 2018	October 31, 2017	% Change	January 31, 2018
HSA Members	3,677	3,013	22 %	3,403
Average HSA Members - Year-to-date	3,540	2,873	23 %	2,952
Average HSA Members - Quarter-to-date	3,642	2,977	22 %	3,189
New HSA Members - Year-to-date	338	339	— %	723
New HSA Members - Quarter-to-date	119	123	(3) %	404
Active HSA Members	2,972	2,536	17 %	2,863
HSA Members with investments	153	98	56 %	122

How they Make Money:

- % of Revenue as of 2Q
- Services: 35%
- Custodial/Record Keeping: 43%
- Interchange: 22%
- Monthly service revenue through contracts with network partners and custodial agreements with individual members.
- Custodial Revenue from cash assets in banks or invested in annuity contracts with insurance company partners.

- Recordkeeping fees for assets held with investment partner and investment advisory services through registered investment advisor subsidiary.
- Interchange revenue, which is primarily interchange fees charged to merchants on payments made with our cards via payment networks

Change in Focus:

Management outlined progress in their five-year strategy to shift their revenue streams in the Q2 Earnings call. The Q2 YoY percent of service revenue decreased from 40% to 35%. 1H 2018 Margins on service, custodial, and Interchange are 29%, 86% and 76%, respectively. The company is targeting increases in custodial assets, as their highest margin business. Q2 saw a 31% increase in AUM, which reflects the strategy, and the growing demand for HSAs in the U.S.

Custodial AUM (Million) Change:

Custodial assets (unaudited)

(in millions, except percentages)	October 31, 2018	October 31, 2017	% Change	January 31, 2018
Custodial cash	\$ 5,583	\$ 4,593	22%	\$ 5,490
Custodial investments	1,507	987	53%	1,289
Total custodial assets	\$ 7,090	\$ 5,580	27%	\$ 6,779
Average daily custodial cash - Year-to-date	\$ 5,503	\$ 4,470	23%	\$ 4,571
Average daily custodial cash - Quarter-to-date	\$ 5,551	\$ 4,550	22%	\$ 4,876

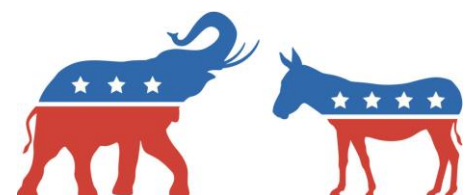
Revenue and Costs (Thousands) Change:

(in thousands, except percentages)	Three months ended July 31,				Six months ended July 31,			
	2018	2017	\$ Change	% Change	2018	2017	\$ Change	% Change
Service revenue	\$ 24,935	\$ 22,809	\$ 2,126	9%	\$ 49,756	\$ 45,298	\$ 4,458	10%
Custodial revenue	30,715	21,285	9,430	44%	59,149	40,604	18,545	46%
Interchange revenue	15,417	12,785	2,632	21%	32,066	26,400	5,666	21%
Total revenue	\$ 71,067	\$ 56,879	\$ 14,188	25%	\$ 140,971	\$ 112,300	\$ 28,671	26%

(in thousands, except percentages)	Three months ended July 31,				Six months ended July 31,			
	2018	2017	\$ Change	% Change	2018	2017	\$ Change	% Change
Service costs	\$ 17,199	\$ 14,998	\$ 2,201	15%	\$ 35,246	\$ 30,573	\$ 4,673	15%
Custodial costs	3,502	2,785	717	26%	6,941	5,588	1,355	24%
Interchange costs	3,791	3,294	497	15%	7,853	6,598	1,255	19%
Total cost of revenue	\$ 24,492	\$ 21,077	\$ 3,415	16%	\$ 50,040	\$ 42,757	\$ 7,283	17%

Favorable Legislation:

The average American couple will need \$265,000 to cover out-of-pocket health care costs in retirement. One of President Trump's initiatives in



healthcare reform is to expand HSA use and leverage its tax shelter to reduce health-care costs. On July 25, 2018, the house passed two health care bills that, if passed through the senate, could raise HSA contributions to \$6,650 for individuals and \$13,000, which are nearly double the current limits, and eliminate multiple disqualifying laws on potential HSA users. These bills will likely create new accounts and let existing members contribute more to their accounts, which will increase revenue by a substantial amount.

Current Limits:

Tax year	HSA contribution limit	
	Individual	Family
2018	\$3,450	\$6,900
2019	\$3,500	\$7,000

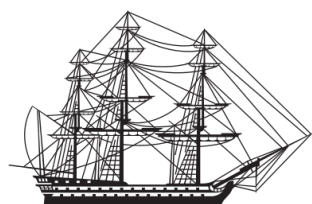
Interest Rate Benefit:

The long-term outlook is that interest rates will continue to rise as the economy grows. HealthEquity is poised to benefit from these hikes. A significant amount of their custodial revenue comes from interest rates offered by their FDIC-insured custodial depository bank partners. They have contracts with fixed or variable interest rates that range from three to five years. As re-enrollment occurs as contracts expire, yields will increase, which will lead to revenue. The recent increase will not have an immediate effect, but will be highly beneficial over time.



Competition Initiative: Partnership with Vanguard:

Large retail mutual fund companies have yet to engage heavily with the HSA market. Their brand recognition and wealth of experience could create major competition for HealthEquity. Management proactively entered into a partnership with Vanguard, which has approximately 5.1 trillion AUM. According to the Vanguard press release, "Vanguard will offer plan sponsors the ability to provide an HSA solution to their employees that features low-cost Vanguard funds or the same investment options as their DC plan line-up." The partnership serves to mitigate the risks of major player like Vanguard entering the market independently.



Vanguard®

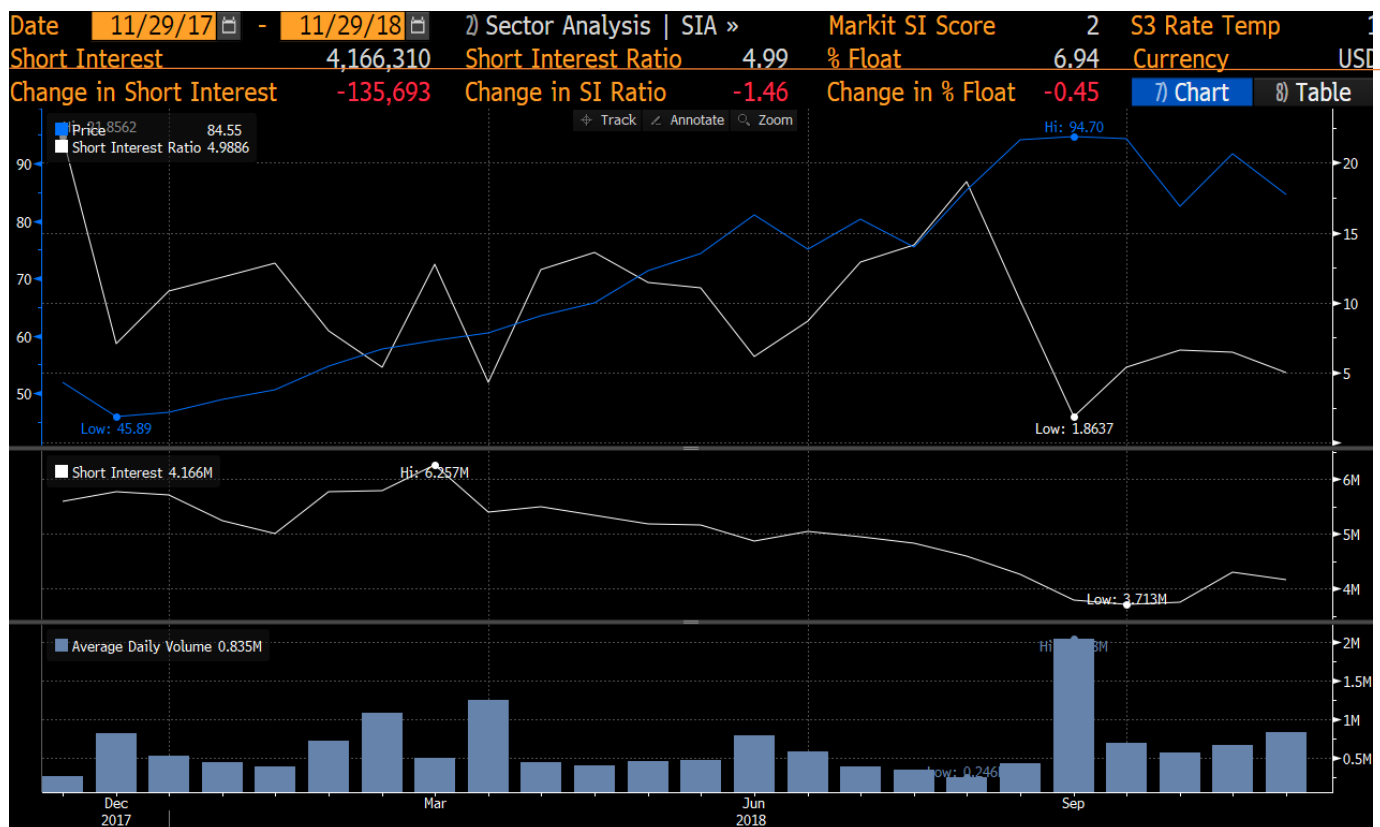
Ownership:

Hedge Funds have remained consistent over the last three quarters. Investment advisors have increased their stake, as HealthEquity's prospects have remained bullish.



Short Interest:

The Short interest dropped significantly around the high in price as losses realized. It is safe to say that investors are long on HQY.



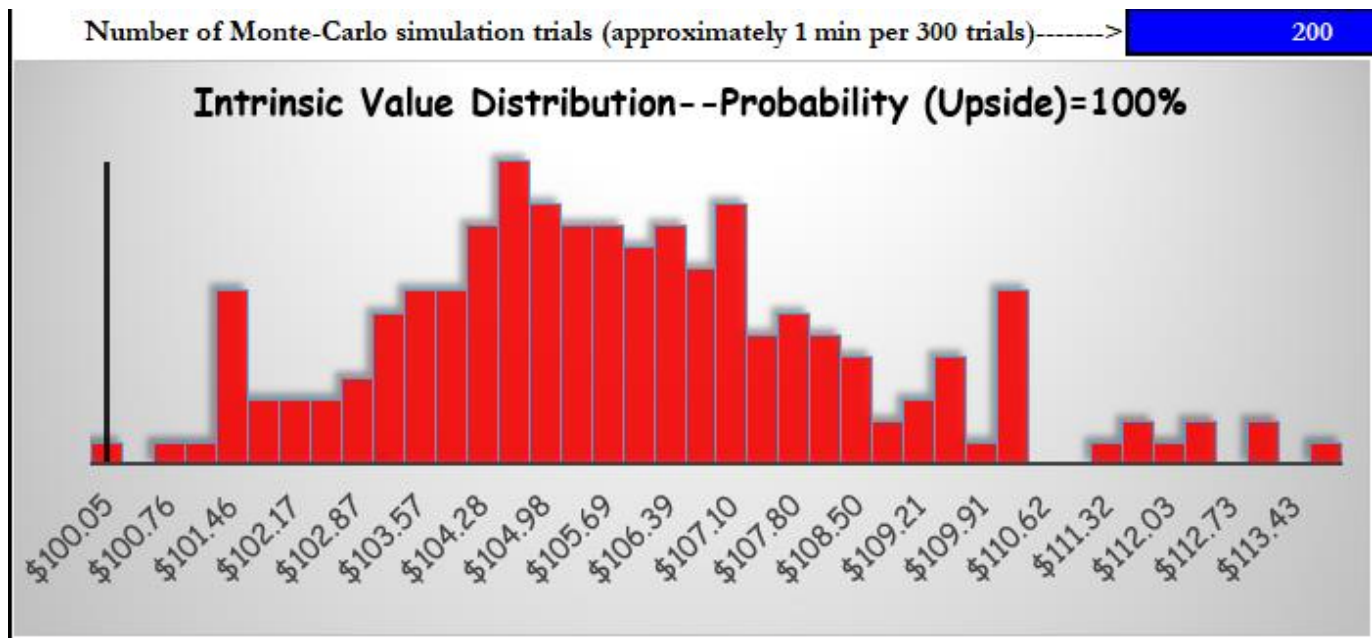
Conclusion:

HealthEquity continues to use its platform to attract new customers and to increase their contributions to their HSAs. Favorable legislation could potentially open the floodgates in terms of these factors. Management is pushing to create new partnerships that mitigate risk, while increase the reach of HQY. Interest rate hikes have the potential to bolster the custodial revenue stream in the long-run. HSAs are a highly useful investment vehicle for health expenses. The founder, Stephen D. Neeleman, MD, foresaw the major growth in out-of-pocket expenses. HealthEquity is poised to expand as the market for HSAs sees major growth.

Base Case:

Target 1yr Value: 119.15

Based off the belief in legislation changes in the coming year.



HealthEquity, Inc. (HQY)

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analysis by Al Capone
12/4/2018

Current Price:
Dividend Yield:

\$83.60
0.0%

Intrinsic Value
Target Price:

\$105.19
\$118.59

Target 1 year Return: 41.85%
Probability of Price Increase: 100%



Description	
HealthEquity, Inc. provides various solutions for managing health care accounts, health reimbursement arrangements, and flexible spending accounts for health plans, insurance companies, and third-party administrators in the United States.	
General Information	
Sector	Health Care
Industry	Health Care Providers and Services
Last Guidance	May 8, 2018
Next earnings date	December 4, 2018
Market Assumptions	
Estimated Equity Risk Premium	5.08%
Effective Tax rate	21%

Market Data	
Market Capitalization	\$5,585.45
Daily volume (mil)	0.99
Shares outstanding (mil)	62.26
Diluted shares outstanding (mil)	62.58
% shares held by institutions	95%
% shares held by investment managers	87%
% shares held by hedge funds	4%
% shares held by insiders	2.60%
Short interest	6.69%
Days to cover short interest	4.73
52-week high	\$101.58
52-week low	\$42.92
Volatility	0.00%

Quarter ending	Part Earnings Surprise
7/31/2017	2.07%
10/31/2017	2.46%
1/31/2018	3.66%
4/30/2018	1.46%
7/31/2018	1.82%
Mean	2.30%
Standard error	1.0%

Revenue	EBITDA
7/31/2017	-6.98%
10/31/2017	-12.56%
1/31/2018	-9.56%
4/30/2018	-9.69%
7/31/2018	-7.72%
Mean	-9.30%
Standard error	4.5%

Market and Credit Scores	
Recommendation (STARS) Value--0	
Recommendation (STARS) Description--0	
Quality Ranking Value--NR	
Quality Ranking Description--Not Ranked	
Short Score--2	
Market Signal Probability of Default % (Non-Rating)--0.01%	
Credit Model Score (Non-Rating)--N/A	
Industry and Segment Information	
LTM Revenue by Geographic Segment	LTM Revenue by Business Segment
United States of America--100%	Pharmacy Services--100%
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Management	Partitions
Kozler, Jan	President, CEO & Director
Matt, Darcy	Executive VP & CFO
Dreier, Ashley	Executive VP, CTO & Chief Information Officer
Otten, William	Executive Vice President of Sales
Bloomberg, Edward	Executive VP & COO
Putnam, Richard	Vice President of Investor Relations

Total Compensation Growth	Stock Price Growth During Tenure
55.04% per annum over 5y	39.97% per annum over 3y
31.25% per annum over 3y	27.77% per annum over 2y
7.14% per annum over 2y	49.15% per annum over 1y

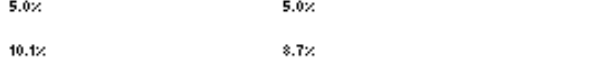
Peers	
Computer Programs and Systems, Inc.	athenahealth, Inc.
Teladoc Health, Inc.	Corner Corporation
Evalant Health, Inc.	--
NextGen Healthcare, Inc.	--
Allscripts Healthcare Solutions, Inc.	--

Profitability	HQY (LTM)	HQY Historical	Peers' Median (LTM)
Return on Capital (GAAP)	54.1%	34.98%	9.16%
Operating Margin	40%	28.54%	18.42%
Revenue/Capital (GAAP)	1.35	1.23	0.50
ROE (GAAP)	17.3%	12.4%	13.0%
Net margin	21.6%	13.4%	12.1%
Revenue/Book Value (GAAP)	0.801917397	0.92	1.07

Invested Funds	HQY (LTM)	HQY Historical	Peers' Median (LTM)
CapEx/Capital	63.5%	53.6%	9.5%
NWC/Capital	1.8%	1.1%	0.2%
Operating Assets/Capital	33.8%	44.5%	50.7%
Goodwill/Capital	1.0%	2.0%	40.0%

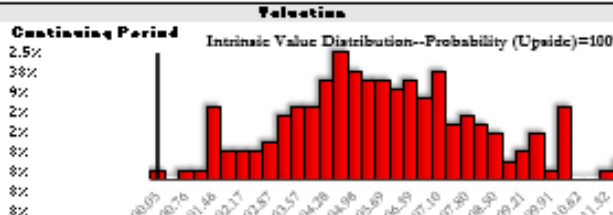


Capital Structure	HQY (LTM)	HQY Historical	Peers' Median (LTM)
Total Debt/Market Capitalization	0.04	0.04	0.20
Cost of Debt	5.0%	5.0%	5.0%
CGFS Rating (F+care, Z+care, and default Probability: AA			
WACC	14.6%	10.1%	8.7%

Valuation	
Intrinsic Value Distribution--Probability (Upside)=100%	
	

Sensitivity Attribution Analysis	
Revenue	31.5%
Operating costs	34.5%
Capital expenditures	1.5%
Discount Rate	31.5%

Forecast Assumptions	Explicit Period (14 years)	Continuing Period
Revenue Growth CAGR	15%	2.5%
Average Operating Margin	38%	38%
Average Net Margin	13%	9%
Growth in Capital CAGR	15%	2%
Growth in Claims CAGR	15%	2%
Average Return on Capital	16%	8%
Average Return on Equity	15%	8%
Average Cost of Capital	8%	8%
Average Cost of Equity	8%	8%



Sensitivity Attribution Analysis	
Revenue	31.5%
Operating costs	34.5%
Capital expenditures	1.5%
Discount Rate	31.5%

Activision Blizzard, Inc. : (ATVI)

Peter Costa

Sector: Communication Services

Industry: Entertainment

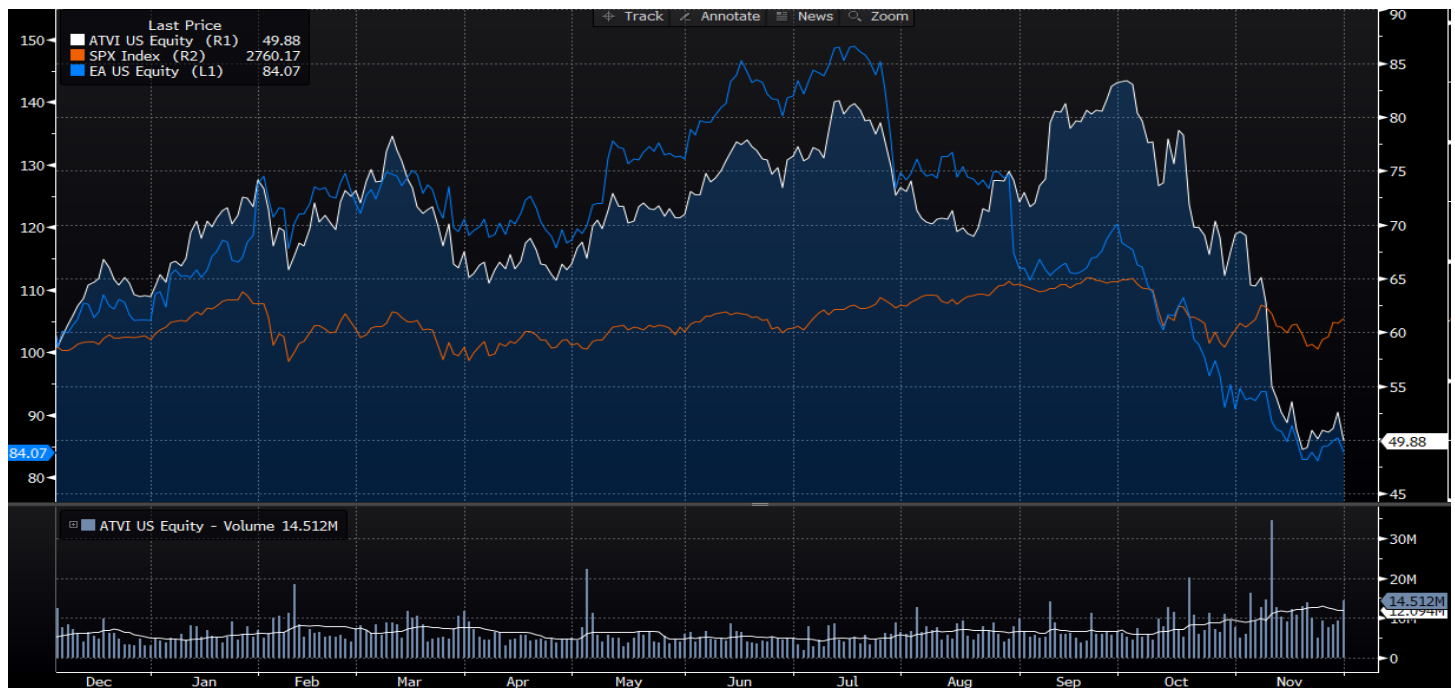
Current Price: \$46.56

Target Price: \$41.77

Company Description: Activision Blizzard, Inc. is a developer and publisher of interactive software and related products. They focus on creating and maintaining franchises that will continue to appeal to their consumers indefinitely. Activision Blizzard, Inc. operates through three distinct segments, Activision, Blizzard and King, each covering a different range of interests.

SELL

Current Price:	\$46.56
Target Price:	\$41.77
Market Cap:	39.5B
Capitalization (D/E):	16%
WACC:	8.98%
ROIC:	4.03%
Cost of Debt	3.58%
52 Week Range	\$46.83 - \$84.68



Thesis: Activision Blizzard, Inc. is a falling leader in the video game industry. They have had consistently declining MAU's for the past 7 quarters. They are failing to produce innovative new content for their main IP's and are missing sales estimates because of this. The revenue growth is projected to slow as they approach maturity, resulting in an intrinsic value similar to the current stock price.

Catalysts:

- Shrinking revenue growth as they approach maturity.
- Continuous decline in MAU's quarter after quarter
- Lack of innovation in their main franchises causing consumers to spend money elsewhere.

Segments Description:

Eight \$1B+ franchises across our portfolio of primarily owned IP



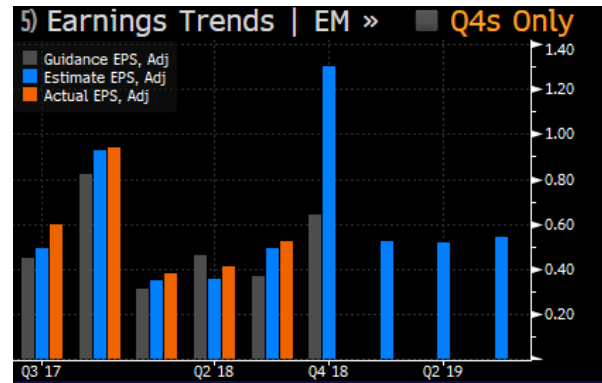
Activision Blizzard, Inc. operates through three different segments, Activision, Blizzard, and King. They each focus on developing their own separate franchises. Activision produces games mainly for console and PC. They are the most cyclical of the segments due to their revenues coming primarily from the release and sale of full games centered on the holidays, and were responsible for 38.8% of total net revenue in 2017. Blizzard

has the most diverse selection of games, and is also working on the Overwatch Esports league which has recently concluded its first season, producing 31.6% of net revenue in 2017. King was acquired in 2016 and is currently focused on the mobile platform for the majority of its revenue which is 29.5% of total net revenue. The three segments combined are able to reach a wide variety of audiences on every platform, offering something for everyone within the industry. Each segment's MAU's, monthly active users, are trending downward which is driving price down (shown below in millions). Activision's 2017 Q4 spike, correlates with the release of their newest Call of Duty title each year. The more titles released will drive up MAU's significantly in the quarter they are released, and in 2017's initial 3 quarters far more titles have been released than in 2018. So far 2018 has been primarily downloadable content and support for the current games, but in Q4 2018 the two largest releases of the year will be coming for Activision and King which will drive the MAU's back up. While there is no doubt this decrease is concerning, it has caused an overreaction by the market that will be rectified in Q4.

	September 30, 2018	June 30, 2018	March 31, 2018	December 31, 2017	September 30, 2017	June 30, 2017
Activision	46	45	51	55	49	47
Blizzard	37	37	38	40	42	46
King	262	270	285	290	293	314
Total	345	352	374	385	384	407

Earnings Performance:

Activision Blizzard, Inc. is a highly cyclical company, they rely on Q4 call of duty release and the holidays to drive yearly revenue. Compared to Q3 2017, Activision has been underperforming, they have been releasing fewer games each year, and are resorting to remastering successful games to try and squeeze more profit out of them. Their new Call of Duty Black Ops 4 is modeled to sell 23.5 Million copies, which is far higher than the 12.19 Million sold from the previous edition. This is where the EPS spike comes from in Q4, but it is already factored into the price. In Q3 2017, the Activision segment generated \$759M of net revenue while only producing \$397M in Q3 2018 due to both the different release schedule, and declining interest in their popular titles. The other two segments stayed more consistent with total net revenue in Q3 2018 of \$1,538M and \$1,818M in Q3 2017.



	Activision
Segment Net Revenues	
Net revenues from external customers	\$ 397
Intersegment net revenues (1)	—
Segment net revenues	\$ 397
Segment operating income	
	\$ 112

	Activision
Segment Net Revenues	
Net revenues from external customers	\$ 759
Intersegment net revenues (1)	—
Segment net revenues	\$ 759
Segment operating income	
	\$ 261

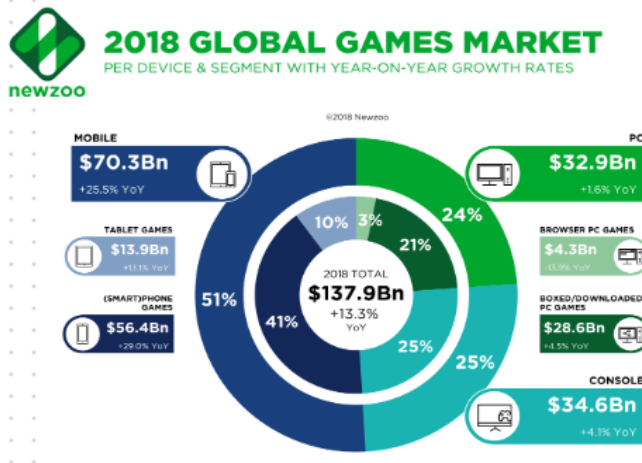
Q3 2018

Q3 2017

Franchises

Activision Blizzard, Inc. mainly focuses on the development and innovation of large franchises that will create and retain consumers over their multiyear lifespan. While Activision Blizzard, Inc. has eight franchises worth over \$1B within their portfolio, they are failing to truly innovate within them and are losing their fan base little by little. According to their Q3 10-Q, “the top 10 titles accounted for 36% of retail sales in the U.S. interactive entertainment industry in 2017, which validates their strategy, it’s just that they have been trying to squeeze too much revenue out of this. They need to continue to release these games, but they also need to innovate to prevent their established fan base from shrinking.

Growth in the Mobile Gaming Industry:

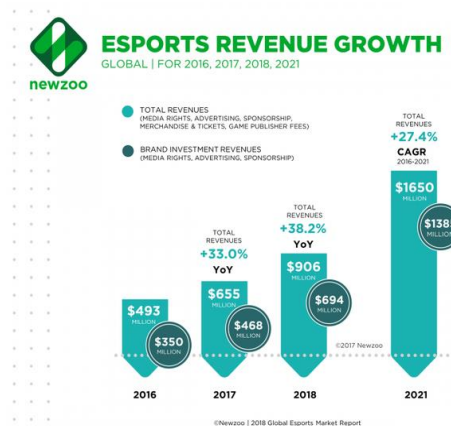


Activision is attempting to establish themselves into the fast growing mobile gaming industry. The mobile gaming industry now accounts for roughly 51% of revenues from the global gaming markets. King, acquired in 2016, is releasing another game for the Candy Crush franchise in Q4 2018. Activision Blizzard, Inc. produced \$2,095M, 29.3% of

its net revenue from mobile platforms in 2017, up from \$1,706M, 25.9% in 2016. With the common smart phone receiving a more powerful operating system with each release, many games that were previously unable to exist are now possible. Activision is trying to capitalize on this trend by bringing some of their most successful franchises to mobile. Mobile gaming is tailored to a far more casual audience, and the reveal of the newest Diablo title being for mobile caused backlash from the “hardcore” community. This backlash was detrimental for Activision, and is largely due to the fans anticipating Diablo IV, presumably the next installment to the franchise, rather than this more casual title. The outcry from the community caused the #notmydiablo movement on twitter showing that their main anticipated fan base will not be supporting this new game in entirety. Activision’s mobile Call of Duty title is will be released in China only at first, but again they are attempting to use their already saturated franchises to produce more and more revenue, and the fan bases are beginning to look elsewhere for more original content.

The Future of Esports:

The possible saving grace for Activision Blizzard, Inc is the growing Esports market. According to Newzoo, a game and Esports analytics company, the global Esports economy is expected to grow by 38% to \$905M with an audience of roughly 380 million viewers by the end of 2018. In 2018 Activision has already been able to complete their inaugural season of The Overwatch League, generating most of their revenue from the sale of teams, and these are just one time sales. Until this league is able to grow far larger in popularity, and begin to make money off advertising, the revenue created will be negligible. Activision Blizzard, Inc. has announced a multiyear deal with Disney for live coverage on ESPN and Disney XD. To help boost competition and local involvement, the Overwatch League assigns its teams a home city much like any other professional sports team. This may be the driver of growth that they need to stay an industry leader, but it is not clear when or if it will become relevant.



Improving Profit Margins:

The gaming industry as a whole is moving towards all digital purchases rather than buying physical copies of games. This is true for all participants in the industry, not just Activision Blizzard, Inc, so well it will help them, it is not a competitive advantage. The industry will be able to increase its profit margins by reducing both distribution and production costs. The movement to all digital products is followed by increased online connectivity, which gives the industry the ability to include more recurring revenue business models. Once consumers either purchase or download a free to play game, the increased connectivity allows them to supply downloadable content and micro transactions within the game to create a more stable generation of revenue. Not only is this a way to provide additional high margin revenues, it will also reduce some of the cyclical nature of their business. As shown below, their margins are projected to continue to improve into the foreseeable future due to lower costs and larger profits coming from reoccurring revenue models. This provides a promising outlook for the industry as a whole, and makes a possible reallocation of funds to a more innovative company in this space.

In Millions of USD 12 Months Ending	2014 Y 12/31/2014	2015 Y 12/31/2015	2016 Y 12/31/2016	2017 Y 12/31/2017	Current/LTM 09/30/2018	2018 Y Est 12/31/2018	2019 Y Est 12/31/2019
Revenue, Adj	4,408.0	4,664.0	6,608.0	7,017.0	7,161.0	7,470.0	7,732.8
Growth %, YoY	-3.8	5.8	41.7	6.2	2.5	6.5	3.5
Gross Profit, Adj	2,883.0	3,079.0	4,214.0	4,516.0	4,673.0	5,341.0	5,598.1
Margin %	65.4	66.0	63.8	64.4	65.3	71.5	72.4
EBITDA, Adj	1,529.0	1,822.0	2,609.0	2,559.0	2,441.0	2,694.7	2,958.1
Margin %	34.7	39.1	39.5	36.5	34.1	36.1	38.3
Net Income, Adj	817.0	887.2	1,060.8	1,106.8	1,279.3	2,014.7	2,178.5
Margin %	18.5	19.0	16.1	15.8	17.9	27.0	28.2
EPS, Adj	1.13	1.20	1.41	1.45	1.67	2.61	2.83
Growth %, YoY	10.7	6.1	17.7	2.7	5.3	79.9	8.4

Short Interest:



Activision's short interest (top) and EA's short interest (bottom) follow a very similar trend. Both stocks have increasing volume reducing the days to cover, while the short interest stays fairly constant. The most concerning part of these charts is the increase in volume coinciding perfectly with the drop in Activision Blizzard's share price. This shows that the large portion of the investors are agreeing with the falling price and will continue driving it down lower. The video game industry as a whole has dropped, but none as much as Activision Blizzard's 40% drop in the past 60 days. This drop in price

has put them close to their calculated intrinsic value, and they will stay around this price until they are able to find new streams of revenue.

More Comparisons Use RV:

Activision Blizzard, Inc. has a very similar business model to Electronic Arts (EA) and Take Two (TTWO), they all produce games year after year for the same franchises with various improvements and changes to keep the player base coming back. Looking at value creation Activision is the only of their two main competitors who is destroying value. Looking at the other two, further analysis is required to decide if reallocating in the video game industry can still meet the return threshold for the fund.

Name (BICS Best Fit)	Ticker	Mkt Cap	ROIC LF	WACC	Px Chg Pct:D-60
Median		6.62B	-1.30%	9.93%	-17.24
100) ACTIVISION BLIZZARD ...	ATVI US	35.50B	4.03%	8.98%	-41.48
101) ELECTRONIC ARTS INC	EA US	24.53B	16.24%	8.48%	-27.71
102) TAKE-TWO INTERACTIV...	TTWO US	11.58B	11.21%	9.93%	-24.07

Conclusion:

Activision Blizzard, Inc. had a disappointing year in 2018 and the stock price is showing it, dropping over 40% in the past 60 days. Their lack of innovation within their revenue driving franchises has begun to drive away lifelong fans, as shown in the declining MAU's. They have slowed down their release schedule without any way to compensate for lower revenue growth. The stock price is very near its intrinsic value with the company doing nothing to drive it back up. One factor that could turn growth around in the future is the emergence of the Esports market, but this is all still in the speculative stage. Activision Blizzard, Inc. has dropped to a reasonable level and will remain here for the foreseeable future, this makes it a sell.

Activision Blizzard, Inc.

(ATVI)

Analysis by Peter Costa

12/19/2018

Current Price:

\$47.23

Dividend Yield:

0.7%

Intrinsic Value

\$41.02

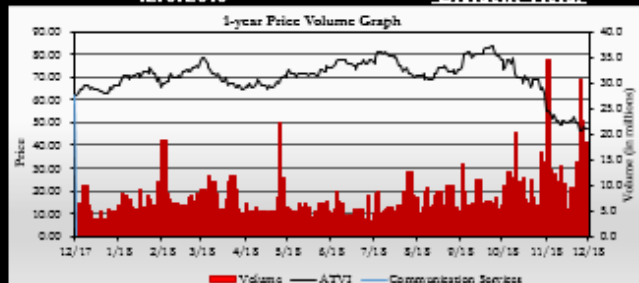
Target Price

\$44.35

NEUTRAL

Target 1 year Return: -5.38%

Probability of Price Increase: 0.3



Description	
Activision Blizzard, Inc. develops and distributes content and services on video game consoles, personal computers (PC), and mobile devices.	
General Information	
Sector	Communication Services
Industry	Entertainment
Last Guidance	May 8, 2018
Next earnings date	February 7, 2019
Market Assumptions	
Estimated Equity Risk Premium	6.16%
Effective Tax rate	23%

Market Data	
Market Capitalization	\$36,038.89
Daily volume (mil)	18.28
Shares outstanding (mil)	763.05
Diluted shares outstanding (mil)	771.25
% shares held by institutions	92%
% shares held by investment managers	78%
% shares held by hedge funds	9%
% shares held by insiders	1.10%
Short interest	2.83%
Days to cover short interest	2.17
52-week high	\$84.68
52-week low	\$45.50
Volatility	29.82%

Quarter ending	
9/30/2017	-6.51%
12/31/2017	-18.93%
3/31/2018	50.69%
6/30/2018	18.57%
9/30/2018	-9.20%
Mean	-6.90%
Standard error	1.0%

Part Earning Surprises	
Revenue	-6.51%
EBITDA	-17.65%
	-159.13%
	68.75%
	22.50%
	-21.24%
	-21.36%
	4.2%

Market and Credit Scores	
Recommendation (STARS) Value--3	
Recommendation (STARS) Description--Hold	
Quality Ranking Value--B+	
Quality Ranking Description--Average	
Short Score--1	
Market Signal Probability of Default % (Non-Rating)--1.05%	
Credit Model Score (Non-Rating)--bbb	

Management	
Katick, Robert	CEO & Director
Jahnson, Callister	President & COO
Neumann, Spencer	Chief Financial Officer
Durkin, Dennis	Chief Corporate Officer
Zaccani, Riccardo	Executive Officer & CEO of King Digital Entertainment
Worob, Stephen	Deputy CFO, Chief Accounting Officer & Senior

Parities	
CEO & Director	-15.07% per annum over 5y
President & COO	13.6% per annum over 5y
Chief Financial Officer	0% per annum over 5y
Chief Corporate Officer	0% per annum over 5y
Executive Officer & CEO of King Digital Entertainment	18.4% per annum over 1y
Deputy CFO, Chief Accounting Officer & Senior	76.18% per annum over 1y

Industry and Segment Information	
LTM Revenue by Geographic Segment	
United States--45%	Activision--37%
Americas (Excluding United States)--6%	Blizzard--30%
United Kingdom--12%	King--28%
Europe, Middle East, and Africa (Excluding United Kingdom)--6%	Unallocated Net Effect from Deferral of Net Revenue--6%
Asia Pacific--13%	

Profitability	
Return on Capital (GAAP)	13.7%
Operating Margin	29%
Revenue/Capital (GAAP)	0.47
ROE (GAAP)	6.8%
Net margin	11.0%
Revenue/Book Value (GAAP)	0.618150259

ATVI (LTM)	
Return on Capital	13.7%
Operating Margin	29%
Revenue/Capital	0.47
ROE (GAAP)	6.8%
Net margin	11.0%
Revenue/Book Value	0.618150259

Peers	
Electronic Arts Inc.	Ubisoft Entertainment SA
Take-Two Interactive Software, Inc.	HEXON Co., Ltd.
Zynga Inc.	Changyou.com Limited
Nintendo Co., Ltd.	Frontier Developments plc
NetEars, Inc.	Kuuhub Inc.

Invested Funds	
Cost of Capital	26.9%
WACC/Capital	-11.1%
Operating Assets/Capital	20.9%
Goodwill/Capital	63.4%

ATVI (LTM)	
Cost of Capital	26.9%
WACC/Capital	-11.6%
Operating Assets/Capital	32.2%
Goodwill/Capital	48.2%

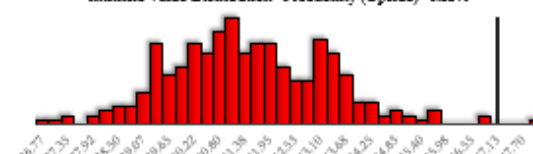
Peers' Median (LTM)	
Return on Capital	25.20%
Operating Margin	32.94%
Revenue/Capital	0.77
ROE (GAAP)	12.5%
Net margin	13.5%
Revenue/Book Value	0.92

Capital Structure	
Total Debt/Market Capitalization	0.30
Cost of Debt	4.8%
CGFS Rating (F-rates, Z-rates, and default Probability: A	
WACC	8.9%

ATVI (LTM)	
Total Debt/Market Capitalization	0.30
Cost of Debt	4.8%
CGFS Rating (F-rates, Z-rates, and default Probability: A	
WACC	8.9%

Peers' Median (LTM)	
Total Debt/Market Capitalization	0.06
Cost of Debt	5.0%
CGFS Rating (F-rates, Z-rates, and default Probability: A	
WACC	11.2%

Intrinsic Value Distribution--Probability (Upside)=0.33%



Sensitivity Attribution Analysis



Company Description: Surgery Partners operates more than 180 surgical and ancillary services facilities. They see over 600,000 annual patients for services specializing in spinal, total joint and cardiac surgery.

BUY

Current Price: \$14.03

Target Price: \$20.21

Market Cap: 641M

ROIC 1.43%

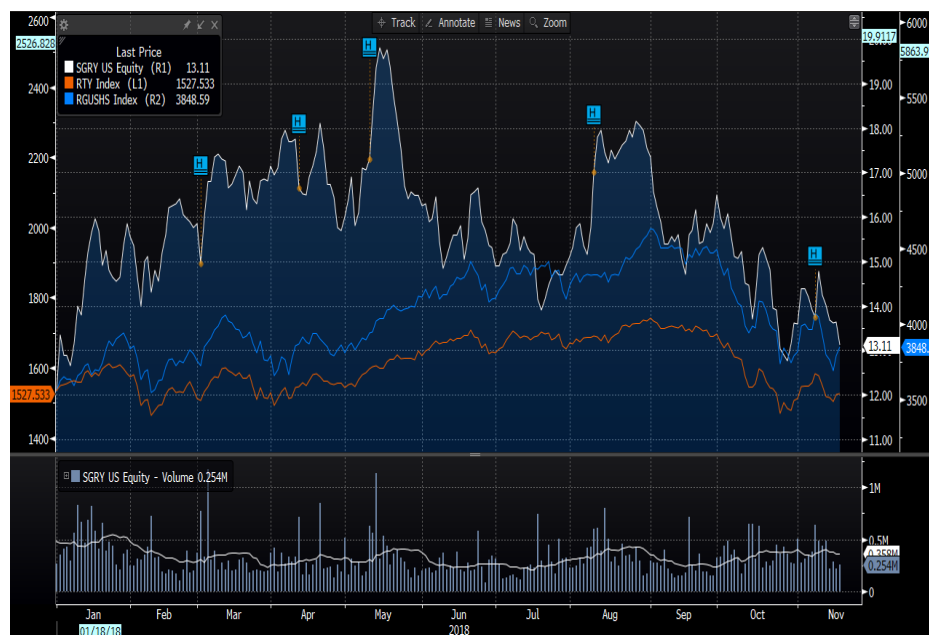
ROIC (w/out Goodwill) 10.8%

Debt/EBITDA 9.58

LTD/Capital 55.24

Current Ratio 1.86

Same-Facility Growth 11.4%



Thesis: Surgery Partners (SGRY) operates Surgical and Ancillary services facilities across the United States. Over the past years, SGRY has focused on acquisitions to increase revenue. Looking forward, SGRY is looking at taking steps to improve efficacy and to realize the economies of scales afforded to them by their large network of facilities.

Catalysts: Forward looking projections that call for positive/negative outlook that will strengthen your thesis. Example:

- Full integration of NHS to take effect in upcoming quarters
- Consolidation of data will improve efficiency
- Surgery mix focusing on higher margin and quicker turnaround procedures
- Reviewing and cutting underperforming facilities improves margins and allows SGRY to focus on core businesses

Earnings Performance:

Surgery Partners (SGRY) saw revenues increase 44.9% from the previous year, coming to \$443.9 million for Q3FY18. This beat projections by \$14.45 million. Much of this growth comes from NSH acquisition, which will be discussed in subsequent sections. Same facility revenue grew 11.4% from Q2FY18. The increasing revenue growth has caused SGRY to raise revenue projections from \$1.75 billion to \$1.8 billion.

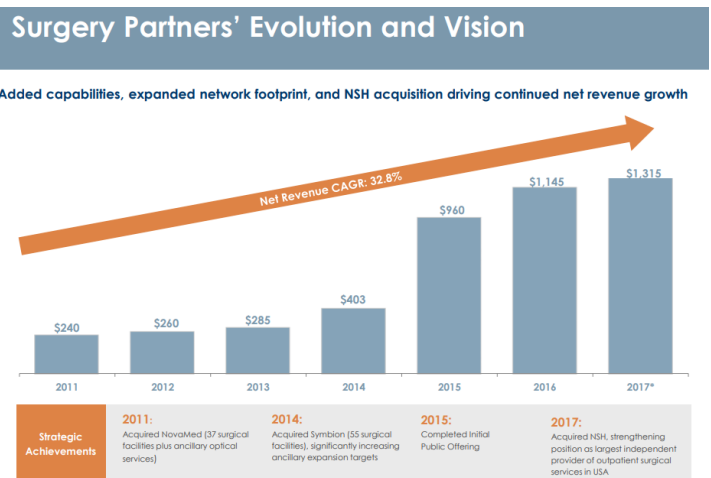
However, the firm decreased EBITDA outlook from over \$240 million to between \$230 and \$235 million. This is due in large part to pruning efforts being made by SGRY to ensure long-term growth. The current adjusted EBITDA LTM is \$321.4 million, an 18.2% margin. This is better than 2017's EBITDA margin of 17.9%, but below 2014, 2015, and 2016's adjusted EBITDA margins, which were all over 20%. When compared to Q3FY17, adjusted EBITDA is up for the quarter by 153.8%.

Same Facility revenue for Q3 was up 11.4% from Q3FY17. Compared to Q3FY17, this increase was caused by a 0.9% increase in same facility cases and a 10.5% increase in revenue per case.

NSH Acquisition:

In 2017, SGRY acquired National Surgical Healthcare, a holding company owning 21 surgical facilities. NSH's facilities specialize in orthopedic, spine and back, pain management, and neurosurgery. These highly specialized procedures offer strong returns for hospitals. We will discuss this later.

The NSH acquisition only affected 4 months of FY17. FY18 will be the first full year NSH has been incorporated with SGRY. Further to that point, NSH has completed most of its integration in Q3FY18. We have yet to see the full impact and benefit of the synergies created from this acquisition. As this integration has been completed in the past several quarters, SGRY has maintained duplicate staff positions between the two firms and has only just executed closing the NSH headquarters in Chicago. As the duplicate positions are cut over the next quarter, this will lead to cost savings for SGRY which will not be fully realized until 2019. Per the Q3FY18 earnings call, SGRY believed it would be able to achieve double digit and sustainable EBITDA growth in 2019 and onward.



Consolidation of Data:

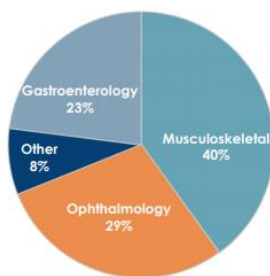
SGRY is currently working toward migrating facility data to one destination platform by the end of the year. Currently 75% of facilities are migrated. SGRY is also working on moving data to a single data warehouse. Currently 90% of surgical facilities have been migrated or about 70% of revenue. With over 180

locations, a centralized data location allows for enhanced data analytics. This will support the firm's decision-making ability and help SGRY find trends and patterns which may be more difficult to spot when the data is not in one location. While there is no direct way to correlate this to financial impact as we have yet to see what the firm finds until they complete the transition, the move should help the firm find areas where revenues can be grown or costs can be cut, overall increasing margins.

SGRY is also working toward moving all facilities to a standardized clearinghouse for claim submissions. This is also expected to be completed by the end of the year. 2 out of 3 facilities have already been migrated into the standardized clearinghouse. This move will improve revenue cycle management, potentially leading to lower costs. SGRY also believes this move will help with revenue leakage, which would increase revenues. All stated, all of these initiatives are expected to be completed by the end of the year, leading to the full benefit being recognized in FY19.

Specialty Mix

Volume



- Drives stable and predictable revenue
- Provides multiple levers to grow volume and increase margins
- Allows flexibility to enter primary and secondary markets

Recruitment and Surgery Mix:

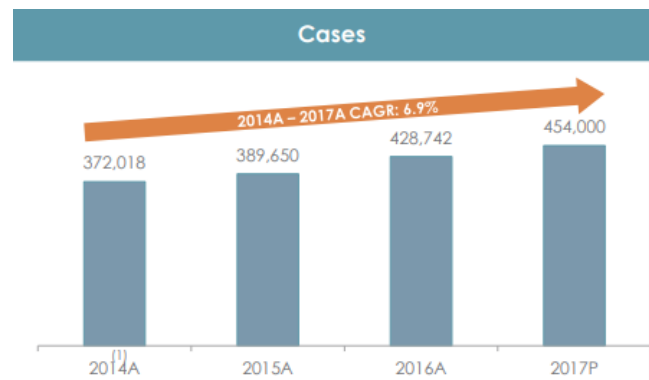
As stated earlier, the acquisition of NSH provided SGRY with specialty facilities for orthopedic, spine and back, pain management, and neurosurgery.

According to Becker's Hospital Review, full-time orthopedic surgeons are each generate approximately \$2.7 million a year in revenue. General orthopedics are among the most desirable of specialists for healthcare facilities. Orthopedics can handle a comparatively large case volume in relatively short amounts of time, this quick turnaround time leading to increased revenue from volume. General orthopedics are also difficult to recruit according to Blue Chip Surgical Partners' president of acquisitions and development Chris Bishop. According to Bishop,

"Most of the busy orthopedists are already invested in surgery centers, so it's hard to find a group that's not invested or eager to leave..." Acquiring NSH has given SGRY access to a strong mix of surgeons that may be difficult to recruit otherwise.

Pain management is another one of the most desirable specialties. Like Orthopedics, these cases take relatively short amounts of time when compared to other procedures. They are also relatively inexpensive to treat, leading to higher margins. One of the main things that determines SGRY's margin is the mix of procedures performed and the cost of each component in that mix. With more relatively inexpensive procedures such as those done by pain management specialists, margins improve.

A main driver of revenue is the recruitment of doctors and specialists to drive case volume. As of Q3FY18, SGRY has recruited 20% more physicians than the same in FY17. Recruitment efforts have been focused on high-growth specialties, driving revenue. As compared to physicians recruited the previous year, revenue and case volume have doubled for this year's recruits. Focusing recruiting efforts on highly-specialized surgeons not only drives revenue but gives a higher rate of return for the money spent on recruitment efforts.



Hedging Against Rising Interest:

The following table summarizes our contractual obligations by period as of December 31, 2017 (in thousands):

	Payments Due by Period				
	Total	Less than 1 year	1-3 years	4-5 years	More than 5 years
Long-term debt obligations, including interest ⁽¹⁾	\$ 2,643,403	\$ 174,406	\$ 1,533,085	\$ 484,374	\$ 451,538
Capital lease obligations, including interest	33,314	9,100	12,424	5,491	6,299
Operating lease obligations ⁽²⁾	564,716	67,513	129,871	109,140	258,192
Other financing obligations, including interest ⁽³⁾	187,476	12,307	25,628	27,043	122,498
Tax receivable agreement	65,141	537	23,613	39,218	1,773
Total contractual obligations	\$ 3,494,050	\$ 263,863	\$ 1,724,621	\$ 665,266	\$ 840,300

⁽¹⁾ Included in long-term debt obligations are principal and interest owed on our outstanding debt obligations. These amounts exclude our unamortized fair value adjustments related non-cash amortization for the Term Loan and 2021 Unsecured Notes. These obligations are explained further in Note 7 to our consolidated financial statements included elsewhere in this report. We used the applicable annual interest rate as of December 31, 2017 of 4.6%, based on LIBOR plus the applicable margin, for our \$1.3 billion outstanding Term Loan to estimate interest payments on this variable rate debt instrument.

⁽²⁾ This reflects our future minimum operating lease payments. We enter into operating leases in the normal course of business. Substantially all of our operating lease agreements have fixed payment terms based on the passage of time. Some lease agreements provide us with the option to renew the lease. Our future operating lease obligations would change if we exercised these renewal options and if we entered into additional operating lease agreements. These obligations are explained further in Note 8 to our consolidated financial statements included elsewhere in this report. Operating lease obligations do not include common area maintenance, insurance or tax payments for which we are also obligated to pay.

⁽³⁾ Other financing obligations includes amounts due under our facility lease obligations at four of our surgical facilities as discussed further in Note 2 to our consolidated financial statements included elsewhere in this report.

SGRY has a substantial amount of debt. Long-term debt makes up 63.6% of SGRY's capital structure with another 1.6% made up of short-term debt as of Q3FY18. In 2017, 68.5% of the capital structure was long-term debt. Paying down the debt will increase the firm's ability to make future acquisitions, growing revenue and creating the opportunities for synergies that can improve efficacy, patient care, and margins. Revenue growth will be able to cover future debt payments.

The rising interest rate environment with this level of debt is concerning. Rising interest rates lead to higher interest payments and lower margins. In Q3 and Q4, SGRY entered into several interest rate swaps to lock in a LIBOR rate of 3.12%. These swaps will hedge the interest on \$900 million worth of debt, which currently accounts for approximately 75% of debt. The swaps reduce a majority of the interest rate risk for the firm, which will benefit them in this rising interest rate environment.

Trimming Underperformers:

As mentioned with the NSH acquisition, there is still consolidation that needs to be made. While a majority was completed in Q3 for the NSH acquisition, there is still consolidation that needs to be done for both NSH and other areas of the company. SGRY is currently analyzing their assets to find those that are underperforming. Year to date, SGRY has closed or sold 19 physician practices and 5 ASCs. The firm also closed the sale of its Family Care Vision practice and optical laboratory. Options are being explored as to the best way to deal with SGRY's remaining optical services.

Another point mentioned earlier was the recruitment focus on core high-growth specialties. SGRY is also considering what to do with current facilities that do not cater to these specialties. These firms could potentially be creating negative synergy within SGRY, which would make it beneficial for SGRY to sell, close, or convert these facilities to focus on those core specialties. Even without negative synergy, these facilities could be producing lower margins than the targeted specialties and EBITDA margins would rise if these facilities were no longer in the equation. Value would be created if SGRY were to prune these facilities. SGRY could use the funds from the sale of these facilities to purchase new facilities in higher margin specialties or use the funds to unlever the firm.

Conclusion:

Over the next few quarters, SGRY will have the opportunity to make the most of economies of scale by realizing synergies, decreasing nonperforming assets and consolidating data and processes. Their strong revenue growth over the past several years will now be paired with improving margins. Overall, if SGRY can take advantage of possible efficiencies in their system, the potential for value creation is strong.

Surgery Partners, Inc. (SGRY)

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analysis by Sam St. Germain

11/18/2018

Current Price:

\$13.11

Dividend Yield:

0.0%

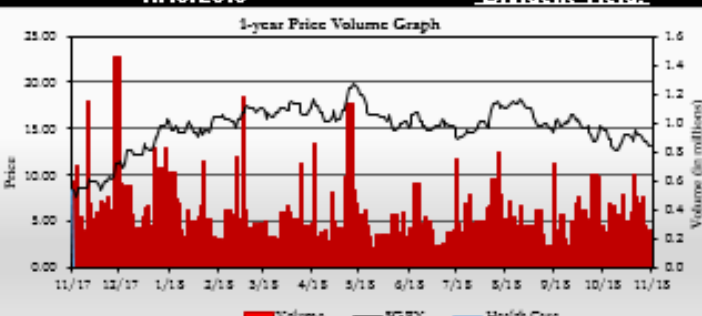
Intrinsic Value

\$12.24

Target Price

\$20.21

Target 1 year Return: 54.13%
Probability of Price Increase: 55%



Description	
Surgery Partners, Inc., through its subsidiaries, operates surgical facilities in the United States.	
General Information	
Sector	Health Care
Industry	Health Care Providers and Services
Last Guidance	May 8, 2018
Next earnings date	February 28, 2019
Market Assumptions	
Estimated Equity Risk Premium	6.00%
Effective Tax rate	21%

Market Data	
Market Capitalization	\$640.97
Daily volume (mil)	0.25
Shares outstanding (mil)	48.89
Diluted shares outstanding (mil)	48.10
% shares held by institutions	45%
% shares held by investment managers	39%
% shares held by hedge funds	4%
% shares held by insiders	8.61%
Short interest	6.80%
Days to cover short interest	10.21
52 week high	\$19.95
52 week low	\$7.55
Volatility	0.00%

Part Earning Surprises	
Quarter ending	Revenue
9/30/2017	-3.57%
12/31/2017	3.03%
3/31/2018	0.81%
6/30/2018	1.38%
9/30/2018	-1.72%
Mean	-0.02%
Standard error	1.0%

Market and Credit Scores	
Recommendation (STARS) Value--0	
Recommendation (STARS) Description--0	
Quality Ranking Value--NR	
Quality Ranking Description--Not Ranked	
Short Score--2	
Market Signal Probability of Default % (Non-Rating)--5.02%	
Credit Model Score (Non-Rating)--B+	

Industry and Segment Information	
LTM Revenue by Geographic Segment	LTM Revenue by Business Segments
United States--100%	Surgical Facility Services--93%
--	Ancillary Services--6%
--	Optical Services--1%
--	--
--	--

Management	
Baldock, Jennifer	Executive VP & Chief Legal Officer
Dean, Dennis	Executive Officer
Adler, Clifford	Consultant & Director
DeVoydt, Wayne	CEO & Director
Cauhey, Thamar	Executive VP, CFO & Principal Accounting Offi
Zelhof, Ronald	Senior Vice President of Operations

Total Compensation Growth	
26.5% per annum over 2y	
55.34% per annum over 1y	

Peers	
HCA Healthcare, Inc.	Quorum Health Corporation
Tenet Healthcare Corporation	LifePoint Health, Inc.
--	--
Universal Health Services, Inc.	Community Health Systems, Inc.
--	--

Profitability	
SGRY (LTM)	SGRY Historical
Return on Capital (GAAP)	2.8%
Operating Margin	8%
Revenue/Capital (GAAP)	0.35
ROE (GAAP)	1.0%
Net margin	0.7%
Revenue/Book Value (GAAP)	1.44

SGRY Historical	
3.11%	
16.03%	
0.19	
1.0%	
0.7%	
1.44	

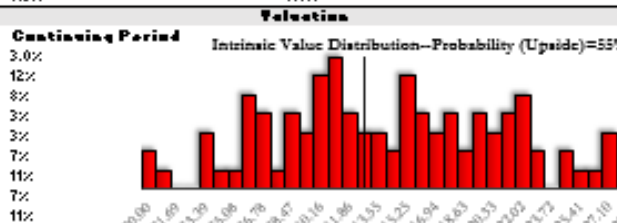


Inverted Funds	
SGRY (LTM)	SGRY Historical
Carh/Capital	0.8%
NWOC/Capital	4.9%
Operating Assets/Capital	-3.9%
Goodwill/Capital	98.2%

SGRY Historical	
2.3%	
2.1%	
46.5%	
49.1%	

Peers' Median (LTM)	
4.76%	
10.30%	
0.46	
2.3%	
7.2%	
0.33	

Capital Structure	
SGRY (LTM)	SGRY Historical
Total Debt/Market Capitalization	0.75
Cost of Debt	6.2%
CGFS Rating (F+care, Z+care, and default Probability)	00
WACC	5.1%



Sensitivity Attribution Analysis	
Revenue	12.1%
Operating costs	18.2%
Capital expenditures	2.7%
Discount Rate	8.0%