HMS Holdings Corp. (HMSY)
Acquires VitreosHealth, Strategic Deal to Enhance Population Health

Maintain Outperform rating. HMSY’s acquisition of VitreosHealth seems very strategic, in our view. We expect VitreosHealth’s predictive analytics platform will enhance HMSY’s current Population Health Management offerings over time. Additionally, HMSY already knows the organization well (VitreosHealth currently supports HMSY’s Eli) and both companies are based in the Dallas area. Financially, the near-term implications for HMSY seem limited, as VitreosHealth currently generates immaterial revenue and the $36.5M purchase price is not needle moving for HMSY (0.2x on EBITDA).

- **Acquires VitreosHealth for $36.5M.** Yesterday evening, HMSY announced the acquisition of VitreosHealth, a predictive analytics company supporting both payers and providers. VitreosHealth is based in Plano, TX (near HMSY’s headquarters) and the company’s key solutions include analytics platforms to support care management, HCC/risk adjustment, and STAR/HEDIS optimization as well as a digital patient engagement solution. VitreosHealth already serves as a key partner for HMSY’s Eli product, which provides member risk intelligence insight to payers. The $36.5M purchase price was funded by HMSY with cash on hand.

- **Strategically positive, financial impact looks limited.** VitreosHealth further expands HMSY’s Population Health Management platform and we think the organization’s solutions will be highly complementary. HMSY’s Population Health platform enables payers to identify high risk members at enrollment (Eli), deploy case management resources (Essette), and engage members (Eliza). In our view, VitreosHealth’s predictive analytics and prescriptive intervention platforms should enhance HMSY’s existing capabilities. We understand VitreosHealth’s revenues are immaterial to HMSY and we don’t think the acquisition will have a meaningful financial impact over the near term.

HMS Holdings (HMSY) is a leading provider of Coordination of Benefit and Program Integrity services to healthcare payers.

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Matthew Gillmor, CFA
Sr. Research Analyst
mgillmor@rwbaird.com
615.341.7113

Connor J. Oleferchik
Research Analyst
coleferchik@rwbaird.com
312.609.5425
Investment Thesis

Our rating on HMSY is Outperform. HMSY has a dominant position with the State Medicaid Coordination of Benefit business and management has leveraged this position to penetrate the higher growth market segments over the past several years, including Commercial and Program Integrity. Additionally, HMSY has started to build a platform to support member Engagement and Care Management functions for payers (via acquisition of Eliza and Essette), and we are optimistic this should improve the company's overall growth profile. In our view, HMSY is on the "right side of the cost curve" and will benefit from multiple macro drivers for the foreseeable future. We think valuation remains attractive given the company's unique positioning.

Valuation and price target. Our $40 price target is based on a ~30x P/E multiple applied to our 2020 estimate. Our assigned multiple is above the high end of HMSY's recent trading range of 20-25x, but in line with long-term average near 25-30x reflecting margin potential upside.

Risks & Caveats

Our suitability rating for HMSY is Higher Risk. Our suitability rating is based on HMSY's historical growth profile, higher margins, strong FCF generation and modest balance sheet leverage, squared against risks associated with state reprocurements and uncertainties related to acquisition integrations.

- **Client concentration and reprocurement.** HMSY's top 10 clients accounted for 41% of revenues during 2016. Historically, HMSY has been very successful retaining clients; however, the loss of a major contract could have a material impact on HMSY and investor sentiment.
- **Information security.** HMSY's services involve the analysis, storage, and transmission of sensitive client and patient information. The inadvertent loss or theft of sensitive information could have an adverse impact on HMSY and the company's ability to compete in the marketplace. HMSY is also subject to various state and federal regulations primarily governed by HIPAA and HITECH legislation.
- **M&A integration risks.** HMSY's historical growth has been driven in part by acquisitions, most notably Eliza (2017), Essette (2016), HealthDataInsights (2011), Allied Management Group (2010) and Benefit Solutions Practice (2006). While we do not model unannounced M&A, the inability to identify and integrate attractive M&A targets could have an impact on HMSY's long-term growth outlook.
- **Other.** Other risks include management turnover, recruiting and retention, HMSY's ability to penetrate the Commercial market, and natural disasters especially with regard to key geographies including the greater Dallas, TX area.

Company Description

**HMS Holdings Corp (HMSY)** is a leading provider of Coordination of Benefit (COB) and Program Integrity (PI) services to healthcare payers, primarily serving State Medicaid programs, Commercial insurers, and the federal Medicare RAC program. Coordination of Benefits services identify third-party liability coverage and helps recover payments made in error. Program Integrity services ensure claims are accurately billed and appropriately paid. HMSY was founded in 1974 and has been serving many State Medicaid clients for decades. HMSY is headquartered in Irving, Texas.
1 Robert W. Baird & Co. Incorporated makes a market in the securities of HMSY.

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