

Change Healthcare (CHNG)

Rating	OUTPERFORM
Price (18-Jul-19, US\$)	13.62
Target price (US\$)	18.00
52-week price range (US\$)	15.00 - 13.62
Market cap(US\$ m)	4,096
Enterprise value (US\$ m)	8,796

Target price is for 12 months.

[V] = Stock Considered Volatile (see Disclosure Appendix)

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INITIATION

Investments Today Pave the Way for a Bright Future; Initiating with an Outperform, \$18 TP

- Favorable Industry Drivers Support Growth Prospects.** Change Healthcare is a leading independent healthcare technology platform offering a comprehensive suite of software, analytics, technology-enabled services and solutions aimed at improving results across all aspects of the complex US healthcare ecosystem. As such, CHNG should benefit from favorable system-wide trends, including a) reducing unnecessary medical spend, b) a growing population of chronically ill and higher-risk patients, c) increasing adoption of value-based care models, d) increasing consumerism of healthcare services, and e) proliferation of healthcare data.
- Predictable and Diversified Revenue Supports LT Growth Targets.** Change Healthcare has predictable and highly diversified revenue, with 88% recurring and no single customer representing greater than 4%. The average tenure of CHNG's top 10 customers is 20+ years. This attractive operating profile allows it to target operating efficiencies (investment and business rationalization) that underpin its long-term growth targets of 4-6% for revenue and 6-8% for EBITDA. FY20 is an investment year for CHNG and, as such, revenue growth is likely to remain below the LT target. However, we expect efficiencies to accelerate CHNG's growth in FY21 and beyond.
- Attractive FCF Profile Should Drive Quick Deleveraging.** We estimate net leverage at 4.5x, relatively higher than its HCIT peers. However, we expect CHNG to apply its strong FCF generation toward de-leveraging.
- Initiate with an Outperform Rating and \$18 PT.** Our \$18 TP is based on 9.5x our CY21 EBITDA estimate. This is roughly a 20% discount to closest-comparable CERN's current multiple. Risks include current investments not yielding desired results and high leverage limiting financial flexibility.

Share price performance



On 18-Jul-2019 the S&P 500 INDEX closed at 2995.95
Daily Jun27, 2019 - Jul18, 2019, 06/27/19 = US\$15.0

Quarterly EPS	Q1	Q2	Q3	Q4
2019A	-	-	-	-
2020E	0.34	0.32	0.37	0.44
2021E	0.31	0.32	0.38	0.43

Financial and valuation metrics

Year	3/19A	3/20E	3/21E	3/22E
EPS (CS adj.) (US\$)	3.56	1.48	1.44	1.54
Prev. EPS (US\$)	-	-	-	-
P/E (x)	3.8	9.2	9.5	8.8
EV/SALES	3.0	3.0	2.8	2.7
Revenue (US\$ m)	3,281.7	3,323.6	3,475.9	3,638.7
EBITDA (US\$ m)	935.0	990.4	1,060.6	1,134.4
EBITDA margin (%)	28.5	29.8	30.5	31.2
EV/EBITDA (current)	10.6	8.9	7.9	7.0
ROIC (%)	13.00	13.24	12.19	13.28
Number of shares (m)	300.76	IC (current, US\$ m)		4,870.89

Source: Company data, Refinitiv, Credit Suisse estimates

DISCLOSURE APPENDIX AT THE BACK OF THIS REPORT CONTAINS IMPORTANT DISCLOSURES, ANALYST CERTIFICATIONS, LEGAL ENTITY DISCLOSURE AND THE STATUS OF NON-US ANALYSTS. US Disclosure: Credit Suisse does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

Change Healthcare (CHNG)

Price (18 Jul 2019): **US\$13.62**; Rating: **OUTPERFORM**; Target Price: **18.00**; Analyst: **Jailendra Singh**

Income Statement	3/19A	3/20E	3/21E	3/22E
Revenue (US\$ m)	3,281.7	3,323.6	3,475.9	3,638.7
EBITDA (US\$ m)	935	990	1,061	1,134
Depr. & amort.	(293)	(329)	(366)	(372)
EBIT (US\$)	642	661	695	762
Net interest exp	(325)	(308)	(284)	(260)
PBT (US\$)	317	353	411	502
Income taxes	(4)	(15)	(78)	(110)
Profit after tax	312	338	333	392
Minorities	-	-	-	-
Net profit (US\$)	479	450	469	512
Reported net income (US\$)	168	183	247	348
Other NPAT adjustments	(311)	(267)	(222)	(164)
Adjusted net income	479	450	469	512
Cash Flow	3/19A	3/20E	3/21E	3/22E
EBIT	642	661	695	762
Net interest	(325)	(308)	(284)	(260)
Change in working capital	(125)	21	39	11
Cash flow from operations	288	497	667	729
CAPEX	(247)	(262)	(250)	(248)
Free cashflow to the firm	41	235	417	482
Acquisitions	0	0	0	0
Divestments	160	0	0	0
Cash flow from investments	(106)	(262)	(250)	(248)
Net share issue/(repurchase)	0	811	0	0
Dividends paid	0	0	0	0
Changes in Net Cash/Debt	104	1,076	417	482
Balance Sheet (US\$)	3/19A	3/20E	3/21E	3/22E
Assets				
Cash & cash equivalents	49	242	359	441
Account receivables	760	707	738	770
Other current assets	172	154	160	167
Total current assets	980	1,103	1,258	1,378
Total fixed assets	197	164	116	63
Investment securities	-	-	-	-
Total assets	6,204	6,295	6,319	6,317
Liabilities				
Total current liabilities	890	839	916	965
Total liabilities	7,109	6,207	5,984	5,633
Shareholder equity	(905)	89	336	684
Total liabilities and equity	6,204	6,295	6,319	6,317
Net debt	5,776	4,699	4,282	3,800
Per share	3/19A	3/20E	3/21E	3/22E
No. of shares (wtd avg)	134	303	326	332
CS adj. EPS	3.56	1.48	1.44	1.54
Prev. EPS (US\$)				
Dividend (US\$)	0.00	0.00	0.00	0.00
Free cash flow per share	0.30	0.77	1.28	1.45
Earnings	3/19A	3/20E	3/21E	3/22E
Sales growth (%)	(0.5)	1.3	4.6	4.7
EBIT growth (%)	(0.8)	2.9	5.1	9.7
Net profit growth (%)	6.4	(6.0)	4.2	9.2
EPS growth (%)	6.4	(58.3)	(3.0)	7.2
EBITDA margin (%)	28.5	29.8	30.5	31.2
EBIT margin (%)	19.6	19.9	20.0	21.0
Pretax margin (%)	9.7	10.6	11.8	13.8
Net margin (%)	14.6	13.5	13.5	14.1
Valuation	3/19A	3/20E	3/21E	3/22E
EV/Sales (x)	3.01	2.65	2.41	2.17
EV/EBITDA (x)	10.6	8.9	7.9	7.0
EV/EBIT (x)	15.4	13.3	12.1	10.4
P/E (x)	3.8	9.2	9.5	8.8
Price to book (x)	(2.0)	46.6	13.2	6.6
Asset turnover	0.5	0.5	0.6	0.6
Returns	3/19A	3/20E	3/21E	3/22E
ROE stated-return on (%)	(17.0)	(44.8)	116.4	68.3
ROIC (%)	13.0	13.2	12.2	13.3
Gearing	3/19A	3/20E	3/21E	3/22E
Net debt/equity (%)	(638.3)	5296.7	1275.8	555.7
Interest coverage ratio (X)	2.0	2.1	2.4	2.9
Quarterly EPS	Q1	Q2	Q3	Q4
2019A	-	-	-	-
2020E	0.34	0.32	0.37	0.44
2021E	0.31	0.32	0.38	0.43

Source: Company data, Refinitiv, Credit Suisse estimates

Company Background
Change Healthcare is a provider of revenue and payment cycle management and clinical information exchange solutions, connecting payers, providers, and patients in the U.S. healthcare system.

Blue/Grey Sky Scenario



Our Blue Sky Scenario (US\$) 20.00

Our blue sky valuation assumes there is a clear path for Change Healthcare hitting the upper half of its LT EBTDA growth target of 6-8% in FY21 and FY22, which allows the company to deleverage its balance sheet at a pace faster than currently reflected in our estimates. In such a case, we see shares trading at 10x our 2021 EBITDA estimate, which would yield a valuation of \$20 per share.

Our Grey Sky Scenario (US\$) 13.00

Our grey sky valuation assumes all the investments CHNG is making do not yield desired results and the company's growth in FY21 and FY22 falls below its LT EBTDA growth targets. In such a case, we see shares trading at 8x our 2021 EBITDA estimate, which would yield a valuation of \$13 per share.

Share price performance



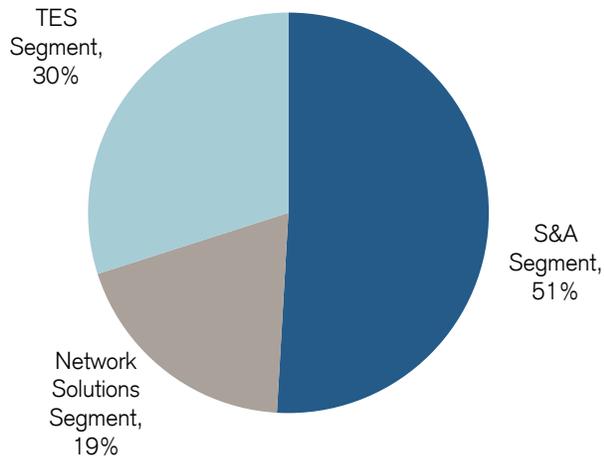
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Table of contents

Key Charts	4
Executive Summary	5
Investment Thesis	7
Favorable Industry Trends	7
Offering Comprehensive End-to-End Solutions for Complex Workflows	7
Leading Clinical and Financial Healthcare Network Provides Scale Advantages	8
High Customer Retention Rate, with Predictable Financial Model.....	8
Cross-Selling Opportunity	9
Synergies and Operational Leverage to Drive Earnings Growth	9
M&A Strategy Designed to Fuel Growth	9
Investment Risks	11
FY20 is Still an Investment Year	11
High Leverage	11
Price Performance and Valuation	12
Detailed Company Overview	14
Software & Analytics (S&A) Segment	14
Network Solutions Segment.....	16
Technology-Enabled Services (TES) Segment.....	17
Organizational Structure	18
Initial Public Offering (IPO).....	20
Financials	21
Software & Analytics (S&A) Segment Financials	21
Network Solutions Segment Financials.....	21
Technology-Enabled Services Segment Financials	21
Industry Trends	22
PEERs Analysis	25
Financial Models	26

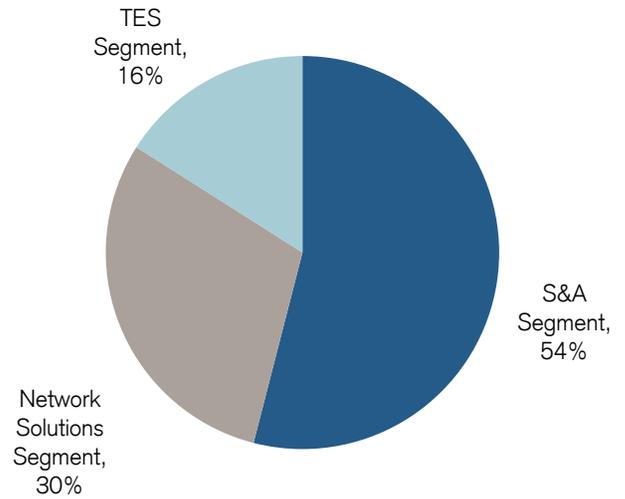
Key Charts

Figure 1: 2018 Revenue % by Segment



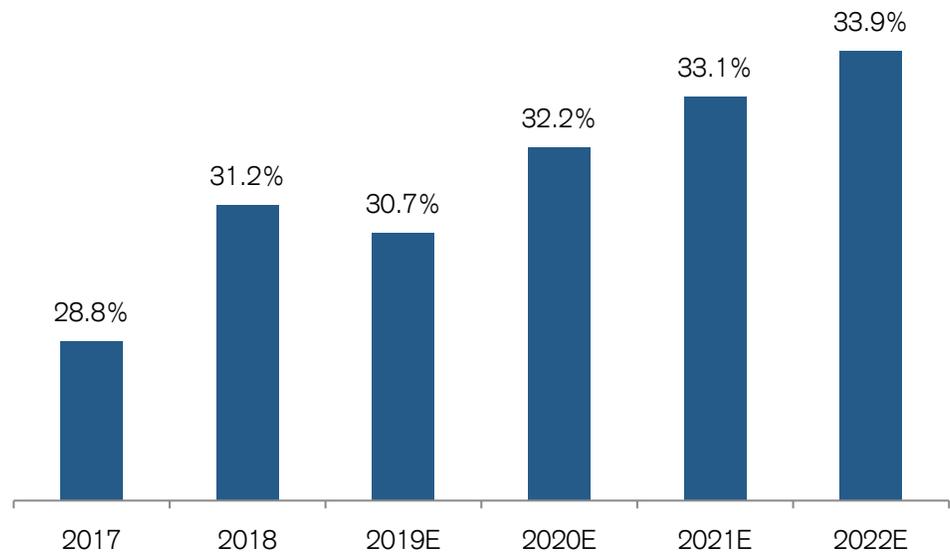
Source: Company data, Credit Suisse

Figure 2: EBITDA % by Segment



Source: Company data, Credit Suisse

Figure 3: Adjusted EBITDA Margin Trend



Source: Company data, Credit Suisse estimates

Executive Summary

We initiate coverage with an Outperform rating and an \$18 target price.

Change Healthcare is a leading independent healthcare technology platform that provides data- and analytics-driven solutions to improve clinical, financial and patient engagement outcomes in the US healthcare system. It offers a comprehensive suite of software, analytics, technology-enabled services and network solutions aimed at improving results in the complex workflows of the healthcare system for payers and providers. The key US healthcare industry trends supporting Change Healthcare's growth prospects include: a) reducing unnecessary spending amidst rising costs, b) a growing population of chronically ill and higher-risk patients, c) increasing adoption of value-based care and reimbursement models, d) increasing financial responsibility of patients and consumerism of healthcare services, and e) the proliferation of healthcare data.

Change Healthcare primarily operates its business via three operating segments: Software & Analytics (S&A), Network Solutions, and Technology-Enabled Services (TES). The company's S&A segment, which represents 51% of CHNG's revenue, offers key solutions for providers and payers including optimizing payment workflow, decision around financial administrative processes, clinical decision making, executing on value-based reimbursement model, and patient engagement. This business includes some of the Change's fastest-growing franchises. With the attributes being very similar to a SaaS company, S&A achieves very healthy margins and represents roughly 54% of the company's overall earnings. CHNG's Network Solutions segment (roughly 19% of revenues) connects almost all of the US healthcare system. This segment provides the CHNG access to more data in a relatively timely manner, which it leverages across its other segments. Network Solutions has been growing for over a decade and achieves a very healthy margin, resulting in the segment representing 30% of CHNG's earnings. The TES segment represents 30% of the company's revenues and 16% of its earnings. This segment's relatively lower margin is primarily a function of its higher labor component. However, the TES segment allows CHNG to provide clients flexibility to buy either modular solutions or complete end-to-end solutions.

Change Healthcare's products and services are already well-embedded in the US healthcare ecosystem across providers, payers, patients and hospitals. Change Healthcare has breadth and scale across financial, clinical and operational IT products and services that address diverse industry challenges and client needs. The company facilitates nearly 14 billion healthcare transactions and approximately \$1 trillion in adjudicated claims (approximately one-third of all US healthcare expenditure). The company's customer base includes approximately 2.2K government and commercial payer connections, 900K physicians, 118K dentists, 33K pharmacies, 5.5K hospitals and 600 laboratories. 19 of the top 20 US payers leverage the company's payment accuracy solutions. Nine of the top 10 Medicare Advantage (MA) plans use the company's risk, quality and engagement solutions. The company's network touches 211 million unique patients with coverage spanning across all 50 states and 90% of all US counties. Change Healthcare's broad network connectivity combined with its use of artificial intelligence (AI) and machine learning (ML) enables it to regularly improve its solutions and uncover new insights as its customers' needs evolve. The company's deep reach across the healthcare ecosystem, and its history of driving innovations, position it to be a preferred partner for its customers. By way of background, about 60% of CHNG's revenue is attributable to providers, while the remaining 40% is attributable to payers.

Change Healthcare has an attractive operating profile given the recurring nature of a significant portion of its revenue, combined with a scalable financial model. The company's revenue is largely derived from predictable transactional, monthly-subscription and per-click formats, as well as contingency-based or long-term contracts. As a result, almost 88% of the company's revenue is recurring. The company's customer base is also

highly diversified, with no single customer representing more than 4% of its revenue. The company's customer retention rate for its top 50 provider and top 50 payer customers has been close to 100% in recent years. The average tenure of its top 10 customers is 20+ years.

Change Healthcare targets long-term revenue growth of 4-6%. It expects this, combined with synergies and operational efficiency, to translate into long-term EBITDA growth of 6-8%. The company's long-term growth outlook excludes M&A opportunities; it acquired and integrated 14 businesses between 2012 and 2018.

Given the lack of trading history, we benchmark CHNG shares against its closest peer, CERN, which trades at roughly 12x 2020 EBITDA (FactSet consensus). However, given FY20 is a transition year for CHNG and due to its relatively high leverage, we believe the shares should trade at a ~20% discount to CERN shares, implying an EV/EBITDA of 9.5x on our CY2021 EBITDA estimate, resulting in our \$18 target price which implies roughly 33% upside potential.

Risks to our Outperform rating and target price for Change Healthcare include the company's current investments not yielding desired results and the company's high leverage limiting financial flexibility. For instance, FY20 (ends March 31) is still a "build" year for Change Healthcare and, as such, revenue growth is likely to remain below its long-term target of 4-6%; our estimate is 1.2%. The company is taking steps this year to 1) strengthen its Intelligent Healthcare Platform; 2) transform underperforming businesses to reposition them for growth; 3) create new enterprise sales capabilities; and 4) expand its solutions set through innovative partnerships and strategic relationships. It is investing in improving the Revenue Cycle Management (RCM) service, repositioning its print business through investments in differentiated technology and products to align with the market shift towards digital communication, and transforming the imaging business to an enterprise cloud-based solution. If any of these initiatives or investments does not spark the growth the company expects, the company's top-line growth could remain below its long-term target. However, FY20 EBITDA growth should be relatively closer to its LT target of 6-8% (we estimate 5.9%) as it benefits from operating efficiency and synergies.

Change Healthcare's current leverage at 4.5x is high compared to the Healthcare IT peers, many of which have no leverage. The company has laid out a plan to de-lever fairly quickly. CHNG has a stable capital structure (currently rated B2 by Moody's and B+ by S&P), significant access to cash and a strong operating cash flow and free cash flow profile. We expect the company to use its FCF to pay down debt. As a result, we estimate the company's leverage improves to 3.4x in FY22. However, this de-leveraging plan is contingent on achieving LT growth rates, which may not happen if investments do not have the expected impact on returns.

Investment Thesis

Favorable Industry Trends

Change Healthcare competes in the market for data- and analytics-driven solutions to the healthcare industry that help providers deliver clinically appropriate care, increase efficiency and reduce unnecessary medical spend. Given the significant and lasting financial burden of rising costs, both government/commercial payers and providers are increasingly focused on reducing costs attributable to administrative complexity and errors, excessive manual labor, and uncoordinated care.

Another key industry driver that should propel growth for Change Healthcare is the growing population of chronically ill and higher-risk patients in the US. Providers and payers need tools to onboard and manage these populations, including the ability to deliver appropriate care for medically-complex patients, and the ability to document risk and outcomes to attain the appropriate reimbursement rates associated with these populations.

Further, Change Healthcare also stands to benefit from the increasing adoption of value-based care and reimbursement models. Both public and private sectors are shifting towards alternative payment models designed to incentivize value and quality throughout an “episode of care.” Many payers and providers are still building the capabilities, expertise and administrative processes to manage these changes adequately. They are partnering increasingly with third parties to demonstrate the achievement of the outcomes required under these value-based payment models, which requires a fundamentally different skillset than has been deployed historically.

Additionally, increasing consumerism of healthcare services is creating a need for personalized solutions and cost, quality, transparency, and decision support tools. Finally, the proliferation of healthcare data is resulting in companies seeking ways to utilize data and identify insights that improve outcome and decrease costs, thus driving a need for Change Healthcare’s software and analytics solutions.

Offering Comprehensive End-to-End Solutions for Complex Workflows

Change Healthcare provides data- and analytics-driven solutions to improve clinical, financial and patient engagement outcomes in the US healthcare system. The company offers a comprehensive suite of software, analytics, technology-enabled services and network solutions that are designed to improve clinical decision making, simplify billing, collection and payment processes, and enable a better patient experience.

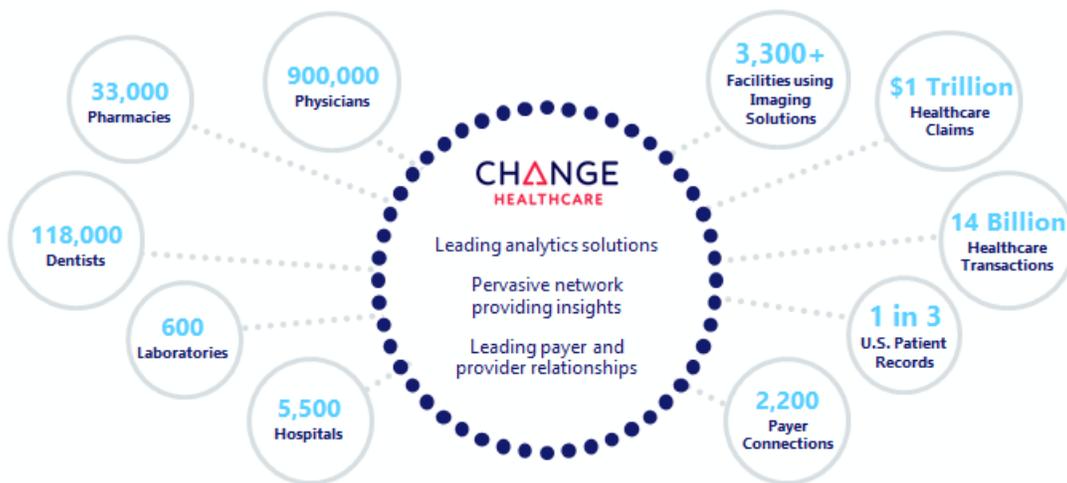
Change Healthcare offers comprehensive, end-to-end solutions with modular capabilities to address its customers’ needs. The company’s offerings range from discrete data and analytics solutions to broad enterprise-wide solutions. As payers and providers become larger and more sophisticated and manage increasingly complex workflows, they will increasingly seek strategic partners with scale and comprehensive, high-value solutions.

Change Healthcare deploys its solutions through complementary software and analytics, technology-enabled services and a network delivery model with the power to target the broad organizational needs of customers such as improved revenue opportunities or reduced operational costs. At the same time, the company’s solutions are modular and flexible, providing the company the ability to address a customer’s needs whether that is a point solution or an end-to-end comprehensive set of products and services. In addition, the company has the ability to deliver integrated solutions throughout its business.

Leading Clinical and Financial Healthcare Network Provides Scale Advantages

Change Healthcare’s Intelligent Healthcare Network is one of the largest clinical and financial healthcare networks in the United States. The company facilitates nearly 14 billion healthcare transactions and approximately \$1 trillion in adjudicated claims or approximately one-third of all US healthcare expenditures. The company serves the vast majority of US payers and providers. Its customer base includes approximately 2,200 government and commercial payer connections, 900,000 physicians, 118,000 dentists, 33,000 pharmacies, 5,500 hospitals and 600 laboratories. This network transacts clinical records for over 112 million unique patients, more than one-third of the estimated total US population. The company’s payment accuracy solutions are embedded in the workflows of 19 of the 20 largest US commercial payers based on covered lives, while its decision support solutions are used by over 4,600 hospitals and facilities, and health plans covering over 100 million members. The company’s broad network connectivity combined with its use of artificial intelligence (AI) and machine learning (ML) enables it to regularly improve its solutions and uncover new insights as its customers’ needs evolve. The company’s deep reach across the healthcare ecosystem, and its history of driving innovations, position it to be a preferred partner for its customers.

Figure 4: Mission-Critical Partner to the Healthcare Industry



Source: Company data

High Customer Retention Rate, with Predictable Financial Model

Change Healthcare has an attractive operating profile given the predictable, recurring nature of a significant portion of its revenue combined with a scalable financial model. The company’s revenue is largely derived from recurring transactional, monthly-subscription and per-click formats, as well as contingency-based or long-term contracts. For the fiscal year ended March 31, 2019, roughly 88% of the company’s revenue was recurring.

The company’s customer base is also highly diversified as no single customer represents more than 4% of its revenue. Change Healthcare’s customer retention rate for its top 50 provider and top 50 payer customers has been almost 100% in recent years. In fact, the average tenure of the company’s top 10 customers has been 20+ years. The company’s high customer retention rates and predictable revenue streams, together with a scalable and capital efficient operating model, provide visibility into its financial results.

Cross-Selling Opportunity

Change Healthcare has significant opportunities to expand the suite of services that its long-tenured and highly loyal customer base purchases through focused cross selling. The company's sales force is focused on expanding the scope and depth of its customer relationships. While the company serves a broad array of providers and payers, several of the company's clients are still under-penetrated in terms of leveraging the company's full suite of products and services. With Change Healthcare's continuing focus of deepening its relationship with its customers and the stickiness of the company's clients, we expect the company's top-line to continue to benefit from its cross-selling efforts across its customer base.

Synergies and Operational Leverage to Drive Earnings Growth

In connection with the McKesson and Change Healthcare transaction announced in March of 2017, Change Healthcare identified opportunities to implement certain cost synergies driven by: a) product integration; b) network efficiencies and combining common products; c) procurement savings from the elimination of duplicate orders, leveraging scale and optimization of providers; d) utilization of global talent; and (iv) reduction of management redundancies and duplicative roles. The company expects to generate approximately \$150 million in annual run-rate synergies, of which the company has realized approximately \$64 mln through the end of FY19. We expect the company to realize an additional \$86 mln of synergy opportunity in FY20 and FY21.

Broadly, the company continues to streamline costs and has instituted cost improvement initiatives throughout the organization. Since creating the joint venture between MCK's technology business and Change Healthcare, CHNG has identified and executed a number of initiatives to improve its operational efficiency and positively impact its operating margins while making significant investments to support its long-term growth. As part of its strategy, Change Healthcare is repositioning certain underperforming solutions to better address end market dynamics and to improve the long-term growth potential of these solutions. CHNG's FY19 margins declined Y/Y, as the company's investments and margin drag from the underperforming businesses more than offset synergy-related margin expansion and margin improvement in outperforming businesses. As the company continues to orient its sales efforts to fully capitalize on its expanded customer value proposition and capture opportunities, the company's margin trends should improve in FY20 and beyond.

M&A Strategy Designed to Fuel Growth

Change Healthcare has strategically focused on key M&A that has helped fuel rapid growth. Since 2012, Change Healthcare has acquired and integrated 14 businesses. The company uses rigorous criteria to evaluate M&A opportunities, which has allowed the company to leverage synergies and further develop customer reach. Historically, the company has approached some of these acquisitions in a "Partnership-First" manner. By doing this, Change Healthcare is able to reduce risk and exposure that the company may face on any acquisition.

Some of Change Healthcare's major acquisitions include HealthQx and NDSC. The acquisition of HealthQx helped Change Healthcare add new payers which increased the amount of people the company's platform covers. Similarly, the purchase of NDSC helped expand customer reach and accelerate revenue growth. The acquisition of NDSC started out as a partnership and then transitioned into an acquisition. Separately, eRx Network presents a future M&A opportunity that is a result of the McKesson transaction. The company was spun-out of legacy Change Healthcare prior to the McKesson transaction

and the Change Healthcare subsidiary has an option to acquire it at an exercise price of \$1.00 for the first \$14 mln in eRx adjusted EBITDA plus a market-based multiple of incremental eRx LTM adjusted EBITDA, which we estimate would be highly accretive to CHNG upon execution. eRx provides claims processing and editing, real-time insurance verification, e-prescribing, and medical and vaccination claims billing. Therefore, exercising this option would provide comprehensive, flexible solutions for pharmacies, efficiency through integration with CHNG's existing pharmacy workflows and access to all major US third-party processors. However, certain terms must be met before this option can be exercised, specifically that McKesson has less than a 5% ownership interest in Change Healthcare.

Investment Risks

FY20 is Still an Investment Year

FY20 (ends March 31, 2020) is still a “build” year for Change Healthcare as the company’s revenue growth is likely to remain below its long-term target of 4-6%, with our current estimate being 1.2%. Specifically, the company is taking steps this year to 1) strengthen its Intelligent Healthcare Platform; 2) transform underperforming businesses to reposition them for growth; 3) create new enterprise sales capabilities; and 4) expand its solutions set through innovative partnerships and strategic relationships. The company is investing in improving the Revenue Cycle Management (RCM) service, building out print capabilities and transforming the imaging business to an enterprise cloud-based solution. Currently CHNG is the largest healthcare-focused print communication vendor in the industry with 1.3 billion pieces printed annually. However, with healthcare patients embracing digital communication capabilities and payers placing great importance on member engagement and experience the market has shifted over time. CHNG is repositioning the print capabilities to be in line with this market shift through investments in differentiated technology and products. These three services/products (RCM, Print, and Imaging) combined make up approximately 40% of revenues. If any of these initiatives or investments do not drive the growth the company expects, the company’s top-line growth could remain below its long-term target.

High Leverage

Change Healthcare’s current leverage at 4.5x is high compared to the Healthcare IT peers, many of which have no leverage. The company has laid out a plan to de-lever fairly quickly. CHNG has a stable capital structure (currently rated B2 by Moody’s and B+ by S&P), significant access to cash and a strong operating cash flow and free cash flow profile. The company’s business model requires moderate capital spending to grow, with capital expenditures of less than 6% of the solutions revenue. We estimate around \$235 mln in FCF in FY20 and a further \$417 mln in FY21. We expect the company to use its FCF to pay down debt. As a result, we estimate the company’s leverage improves to 3.4x in FY22.

However, we note that this de-leveraging plan is contingent on achieving LT growth rates, which may not happen if investments do not have the expected impact on returns as discussed above. If returns are lower than expected, this will lead to reduced operating cash flow, making it more difficult for the company to reduce debt.

Figure 5: CHNG Leverage vs. HCIT Peers (FY20 Net Debt/EBITDA)

Company	Ticker	CS Rating	Leverage*
Allscripts Healthcare Solutions	MDRX	Not Covered	1.9x
Cerner	CERN	Not Covered	0.0x
eHealth	EHTH	Outperform	0.0x
HealthEquity	HQY	Not Covered	0.0x
HMS Holdings	HMSY	Outperform	0.2x
Inovalon Holdings	INOV	Not Covered	3.7x
NextGen Healthcare	QSII	Not Covered	0.0x
Premier	PINC	Outperform**	0.0x
R1 RCM	RCM	Not Covered	1.3x
Tabula Rasa Healthcare	TRHC	Not Covered	3.3x
Teladoc Health	TDOC	Neutral	2.9x
Change Healthcare	CHNG	Outperform	4.5x

Source: FactSet, Credit Suisse estimates; * Based on 2020 EBITDA estimates; **Covered by Erin Wright

Price Performance and Valuation

CHNG shares began trading on June 27, 2019. Since then, the stock has appreciated 4.2%. The S&P 500 is up 19.3% this year to date and the S&P500 HC Index is up 6.4% YTD.

Figure 6: Peers and S&P 500 Price Performance

Company Name	Ticker	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019 YTD*
Allscripts Healthcare Solutions, Inc.	MDRX	-4.7%	-1.7%	-50.3%	64.1%	-17.4%	20.4%	-33.6%	42.5%	-33.7%	14.2%
Cerner Corp.	CERN	14.9%	29.3%	26.5%	43.8%	16.0%	-6.9%	-21.3%	42.3%	-22.2%	39.0%
Change Healthcare, Inc.	CHNG	-	-	-	-	-	-	-	-	-	4.2%
Cotiviti Holdings, Inc.	COTV	-	-	-	-	-	-	92.8%	-6.4%	38.9%	-
eHealth, Inc.	EHTH	-13.6%	3.6%	86.9%	69.2%	-46.4%	-60.0%	6.7%	63.1%	121.2%	127.5%
HealthEquity Inc.	HQY	-	-	-	-	50.1%	-1.5%	61.6%	15.2%	27.8%	32.7%
HMS Holdings Corp.	HMSY	33.0%	48.1%	-18.9%	-12.4%	-6.9%	-41.6%	47.2%	-6.7%	66.0%	18.3%
Inovalon Holdings, Inc.	INOV	-	-	-	-	-	-37.0%	-39.4%	45.6%	-5.5%	3.7%
NextGen Healthcare, Inc.	NXGN	11.2%	6.0%	-53.1%	21.3%	-26.0%	3.4%	-18.4%	3.3%	11.6%	30.0%
Premier Inc.	PINC	-	-	-	16.0%	-8.8%	5.2%	-13.9%	-3.9%	28.0%	5.2%
R1 RCM, Inc.	RCM	25.3%	41.4%	-49.6%	-20.9%	-25.1%	-53.4%	-29.7%	96.0%	80.3%	62.1%
Tabula Rasa Healthcare, Inc.	TRHC	-	-	-	-	-	-	4.6%	87.2%	127.3%	-13.5%
Teladoc Health, Inc.	TDOC	-	-	-	-	-	-43.1%	-8.1%	111.2%	42.2%	38.9%
Average		11.0%	21.1%	-9.7%	25.9%	-8.0%	-21.4%	4.0%	40.8%	40.2%	30.2%
S&P 500 Health Care Index		0.7%	10.2%	15.2%	38.7%	23.3%	5.2%	-4.4%	20.0%	4.7%	6.4%
S&P 500		12.8%	-0.0%	13.4%	29.6%	11.4%	-0.7%	9.5%	19.4%	-6.2%	19.3%

Source: FactSet

*YTD through 07/19/2019; RCM price starting 05/31/2010; PINC price starting 09/30/2013; HQY price starting 08/01/2014; INOV price starting 02/12/2015; TDOC price starting 07/31/2015; COTV priced 05/27/2016 to 08/24/2018; TRHC price starting 09/30/2016; CHNG price starting 06/27/2019

Given the lack of trading history, we benchmark CHNG shares against its closest peer, CERN, which currently trades at roughly 12.0x 2021 EBITDA (FactSet consensus). However, given FY20 is a transition year for CHNG and due to its relatively high leverage, we believe CHNG shares should trade at a ~20% discount to CERN, implying an EV/EBITDA of 9.5x on our 2021 EBITDA estimate, from which we derive our \$18 target price which implies roughly 33% upside potential.

Figure 7: Comparable Analysis

Company	Ticker	CS Rating	Share Price	EV/Revenue			EV/EBITDA		
				2019E	2020E	2021E	2019E	2020E	2021E
Allscripts Healthcare	MDRX	Not Covered	\$11.07	1.4x	1.3x	1.3x	8.2x	7.5x	7.1x
Cerner	CERN	Not Covered	\$73.23	4.1x	3.9x	3.6x	14.0x	12.3x	11.7x
eHealth	EHTH	Outperform	\$87.48	5.4x	4.5x	3.7x	31.2x	21.7x	14.6x
HealthEquity	HQY	Not Covered	\$79.35	13.9x	12.2x	NM	34.5x	28.6x	NM
HMS Holdings	HMSY	Outperform	\$33.43	4.6x	4.3x	3.9x	16.9x	15.2x	13.6x
Inovalon Holdings	INOV	Not Covered	\$14.75	4.7x	4.3x	4.1x	14.8x	13.3x	12.3x
NextGen Healthcare	QSII	Not Covered	\$19.79	2.3x	2.2x	2.1x	13.2x	11.7x	8.8x
Premier	PINC	Outperform**	\$39.38	3.0x	4.0x	3.8x	9.2x	8.8x	8.4x
R1 RCM	RCM	Not Covered	\$12.98	1.4x	1.3x	1.1x	11.2x	7.1x	5.6x
Tabula Rasa Healthcare	TRHC	Not Covered	\$55.32	4.6x	3.7x	3.1x	33.6x	22.8x	18.6x
Teladoc Health	TDOC	Neutral	\$69.02	9.3x	7.6x	6.3x	171.4x	86.0x	60.3x
Change Healthcare*	CHNG	Outperform	\$13.52	2.7x	2.6x	2.5x	9.4x	8.7x	8.2x

Source: Company data, Credit Suisse estimates; *Based on Calendar Year; **Covered by Erin Wright; Data as of July 18, 2019

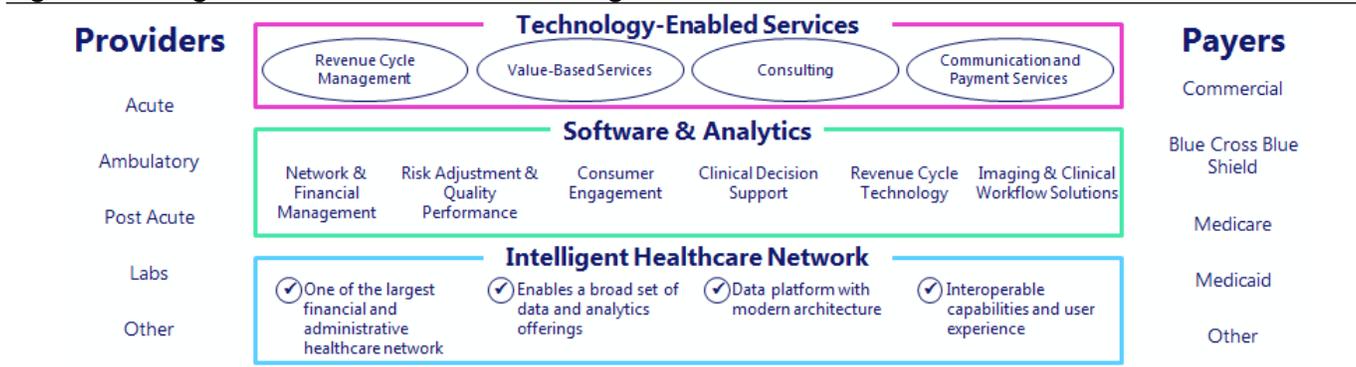
Our blue sky valuation assumes there is a clear path for Change Healthcare to achieve the upper end of its LT EBTDA growth target of 6-8% in FY21 and FY22, which allows the company to deleverage its balance sheet at a pace faster than currently reflected in our estimates. In such a case, we assume the shares trade at 10x our 2021 EBITDA estimate, which yields a blue sky value of \$20 per share.

Our grey sky valuation assumes all the investments CHNG is making do not yield desired results and the company's growth in FY21 and FY22 falls below its LT EBTDA growth targets. In such a case, we assume the shares trade at 8x our 2021 EBITDA estimate, which yields our grey sky value of \$13 per share.

Detailed Company Overview

Change Healthcare offers financial, clinical, and engagement solutions in three business segments: Software & Analytics, Network Solutions, and Technology-Enabled Services. The company utilizes its broad portfolio of solutions to serve stakeholders across the healthcare system, including commercial and government payers, employers, hospitals and health systems, physicians and other providers, pharmacies, labs and consumers.

Figure 8: Change Healthcare’s Modular and Integrated Solutions



Source: Company data

Software & Analytics (S&A) Segment

As part of its S&A segment, Change Healthcare provides services which include Network and Financial Management, Risk adjustment, Quality & Engagement, Decision Support, Revenue Cycle Technology, Enterprise Imaging, and Connected Analytics. At a broader level, the segment provides solutions to help customers drive financial performance, improve quality, and succeed in a value-based, consumer driven environment. The segment’s solutions are deeply embedded in its clients’ workflows as it powers critical business functions for the majority of US payers and providers, which makes the company well positioned to innovate. Under this segment, the company provides solutions such as InterQual, ClaimsXten, HealthQx, Assurance, Radiology, Risk Adjustment, & Quality Performance. Under its S&A segment, the company’s payment accuracy solutions are leveraged by 19 of the top 20 US payers . Nine of the top 10 MA plans use CHNG’s risk, quality and engagement solutions. The company also provides clinical decision support to greater than 4,600 hospitals and facilities and health plans covering almost 100 million lives.

Network & Financial Management

As part of its Network & Financial Management business, the company provides end-to-end solutions that enable pay to deliver accurate payments. The company also provides analytics to help payers and providers adopt value-based payment models. Finally, as part of this business, the company also provides solutions to help payers optimize provider networks.

The market trends supporting the growth in this segment include increasing pressure to manage costs, focus on reducing payment complexity, enabling payer-provider collaboration, growth from government lives, shift to value-based payment, and importance of the consumer experience.

The company’s competitors in this business include Optum, Equian (acquired by Optum recently), Cotiviti Holdings, HMS Holdings, etc. The fact that the company services 19 of the top 20 US payers and over 175 million members with its payment solutions provides it a strategic advantage over competitors. Payers representing 65 mln commercial lives have chosen Change Healthcare’s value-based payment analytics platform (HealthQx). The company’s end-to-end payment accuracy solutions have a unique ability to drive “pre-emptive” solutions through provider connectivity.

Risk Adjustment, Quality & Engagement

Change Healthcare also enables risk-bearing entities to address the complex reimbursement and compliance challenges for government-sponsored plans. The company offers a complete set of analytics-driven solutions for member engagement, risk adjustment and quality performance.

The market trends supporting the growth in this segment include expected growth in government lives, increased focus on reducing administrative complexity, continued importance of provider engagement and member experience, focus on Social Determinants of Health (SDoH), and emerging technologies (e.g. AI, NLP).

The company's competitors in this business include Inovalon, Cotiviti, Optum, Pulse8, and Centauri. The fact that the company serves nine of the top 10 MA plans and top five managed Medicaid health plans provides the company a strategic advantage over its competitors in this segment. The company supports more than 45 mln members across risk, quality, and engagement.

Decision Support

As part of its Decision Support business, CHNG offers clinical criteria to help payers and providers make clinically appropriate utilization decisions. The company's integrated solutions deliver medical guidelines to point of care, and automate the authorization process.

The market trends supporting the growth in this segment include increasing pressure to manage costs, growing use of clinical decision support to address inappropriate care, unexplained variance in care, federal mandates, enabling payer-provider collaboration, and emerging technologies.

The company's competitors in this business include Xsolis and MCG Health. Change Healthcare is the industry leader in evidence-based medical appropriateness criteria (acute and ambulatory). The company provides clinical decision support to over 3,700 acute hospitals, 900 provider facilities, 250 commercial health plans, and CMS.

Revenue Cycle Technology

Change Healthcare also offers end-to-end workflow and analytics to automate reimbursement and simplify patient collections for hospitals, physician offices, laboratories and other ancillary care providers.

The market trends supporting the growth in this segment include increasing pressure to manage costs, rise in patient payment responsibilities, increasing administrative complexity, increasing focus on value-based payment, and emerging technologies.

The company's competitors in this business include SSI, n thrive, Experian, Waystar, Epic, and Cerner. More than 2,400 hospitals and health systems use enterprise CHNG's revenue cycle solutions. The company has almost 80K office-based provider customers. Additionally, leading BPOs leverage CHNG's technology and intelligence to drive financial performance. CHNG's technology footprint provides the company leverage for revenue integrity services.

Enterprise Imaging

Change Healthcare's diagnostic imaging solutions help customers improve productivity, optimize performance and enable collaboration across the care continuum.

The market trends supporting the growth in this segment include provider consolidation creating complex system integration, shift from departmental to enterprise imaging solutions, efforts to reduce total imaging costs, and potential to unlock value of imaging data through cloud and AI.

The company's competitors in this business include GE, Carestream, MERGE, AGFA, and Philips Healthcare. CHNG works with >3,300 facilities in the US and Internationally (UK, Ireland, Canada, Australia). The company is the leader in both US radiology systems and the adoption of cardiology reporting, and enables more than 70 mln diagnostic imaging studies/year.

Connected Analytics

As part of the Connected Analytics business, CHNG offers analytics solutions to help providers manage total cost of care. The company's predictive analytics reduce labor costs by forecasting patient demand and optimizing patient flow.

Network Solutions Segment

Change Healthcare's Network Solutions segment powers financial and clinical data exchange across payers, providers, pharmacies, labs, and consumers. The Change Healthcare network is by far the broadest and deepest network in the country. The company's network business is characterized by its flywheel effects: a) **Scale:** efficiently connects across vast majority of payers and providers b) **Value of data:** controlled use of data to improve the quality and efficiency of healthcare; c) **Compounding value:** network growth drives better intelligence. The segment's solutions include Medical EDI Network, Dental EDI Network, B2B payments, C2B payments, MedRx Network, Clinical Network, CommonWell Health Alliance, and Data Solutions. The segment's customers include hospitals/health systems, government and commercial payers, pharmacies, physician groups, dentists, labs, and vendors.

Change Healthcare leverages its Intelligent Healthcare Network—with an industry-leading nearly 14 billion transactions, approximately \$1 trillion in adjudicated claims, and \$150 bln in payments distribution—to enable and optimize connectivity and transactions among healthcare system participants and to generate insight using healthcare data to help meet their analytical needs. The company's network touches 211 mln unique patients with coverage spanning across all 50 states and 90% of all counties in the US.

Networks

Change Healthcare's Networks business connects payers and providers via intelligent networks to exchange financial and clinical data across medical, dental, pharmacy, lab, and EMR domains. The market trends supporting the growth in this segment include payers deriving more value from networks, increasing transaction volumes (due to age and health of population, increasing utilization, and new transaction types), consolidation in all customer segments, competition from point solutions and vertically-integrated competitors, and reimbursement changes.

CHNG's competitors in this segment include Availity, Optum, Experian, n thrive, WayStar, etc. in Medical, EDS, dentalxchange, MedRx, OmniSYS, etc. in Dental, and ELLKAY, ATLAS Medical, Liaison, etc. in Clinical Networks. Change Healthcare has by far the largest network offering end-to-end offerings from eligibility/benefits check through billing and payments. The company's network-driven analytics, RCM software, payment accuracy, and TES solutions make its networks sticky. The company also has a unique differentiation from its comprehensive connectivity with payers, including the "long-tail" of smaller and regional payers. Finally, the company has a channel partner ecosystem with deep integrations spanning more than 700 vendors, including all major EMR vendors.

Payments

Change Healthcare's Payments business facilitates electronic payments between payers, providers, and consumers utilizing a variety of payment methods.

The market trends supporting the growth in this business include continued shift in payments toward digital (administrative efficiency for payers, acceleration of payments for providers, and convenience for consumers), consumer as payer (rising consumer out-of-pocket responsibility - deductibles, HDHP), employers/payers/providers looking to improve the patient billing and payments experience, and government regulations limiting payer spend on administrative costs, leading payers to focus on electronic payments as a key lever.

CHNG's competitors in this business include Softheon, Simplee, Experian, Zelis Healthcare, InstaMed, payspan, SwervePay, Patientco, vpay, etc. Change Healthcare is unique in being able to link payments, member communications, and transactional connectivity together to provide a better and lower-cost end-to-end experience for all stakeholders.

Data Solutions

Change Healthcare's Data Solutions segment enables use of network generated de-identified data for carefully controlled uses that benefit healthcare stakeholders and help improve the quality and efficiency of healthcare.

The market trends supporting the growth in this segment include information asymmetry in healthcare (fragmented system, data blocking, regulatory constraints, and proprietary interests), growing understanding of the importance of combining financial and clinical data to get to more effective insights, shift toward AI/Machine Learning, which requires massive volume of data, rise in consumerism, and continued investments in new frontiers that leverage data (genomics, personalized medicine, clinical trials recruitment, etc.).

CHNG's competitors in this segment include IBM, Milliman, Optum, AdvisoryBoard, Allscripts, Cerner, healthverity, prognos, practicefusion, etc.

Technology-Enabled Services (TES) Segment

Through its TES segment, Change Healthcare provides solutions for revenue cycle and practice management, value-based care enablement, communications and payments, pharmacy benefits administration and consulting. The segment's solutions include Hospital RCM service, Physician Group RCM service, Communications and Payment Services, Value-based Care enablement, Consulting, and Rx Benefits Administration Services. The segment's customers include hospitals/health systems, physician groups, government and commercial payers, and alternative care sites. The segment is primarily centered around the health care financial transaction and is characterized by: a) longevity and dependability (over 30 years of provider revenue management); b) scale (one of largest providers of administrative and financial services to health care providers); and c) breadth and depth (comprehensive solutions). Change Healthcare is the leader in physician revenue cycle outsourcing market. The company processes \$34 bln in annual charges, \$9.2 bln in annual collections, and 207 mln in annual cases/procedures.

RCM Services

Under its RCM Services business, Change Healthcare performs operational functions across the revenue cycle to maximize collections from payers and patients.

The market trends supporting the growth in this segment include increasing reimbursement pressure (with rise of value-based care models), increasing prevalence of high deductible plans driving provider bad debt, provider consolidation and practice aggregation, increased focus on risk sharing, and growth of end-to-end outsourcing in health systems.

CHNG's competitors in this business include R1, n thrive, Epic, athenahealth, OptumInsight, Cerner, NextGen Healthcare, Intermedix, etc. As noted, Change Healthcare is the current market leader in physician RCM services market, and is among top 10 players in Hospital/Health system RCM services market.

Communications & Payment Services

Change Healthcare also provides services related to informing patients of administrative and financial healthcare information and driving collections on patient liability.

The market trends supporting the growth in this segment include increase in patient out-of-pocket costs with rise of high-deductible plans, healthcare patients embracing digital communication capabilities, bundling of patient communications and patient payment solutions, and payers placing great importance on member engagement and experience.

CHNG's competitors in this segment include Shutterfly, Fiserv, Softheon, Patientco, FSSI, payspan, InstaMed, etc. Change Healthcare is the largest healthcare-focused print communications vendor in the industry (1.3 bln pieces annually). The company is the only vendor in Healthcare offering both paper statements and digital payments capabilities.

Payer Services

Payer Services business includes CHNG's payer and advisory services, including value-based care enablement, pharmacy benefits, and consulting.

The market trends supporting the growth in this segment include continued payer consolidation, continued growth in government lives, government regulations limiting payer spend on administrative costs, and regulatory tailwinds continuing shift to value-based care, precipitating need for provider-payer collaboration.

CHNG's competitors in this segment include Optum, Evolent Health, Cognizant, EnvisionRx, Deloitte, MagellanRx management, fluidEDGE consulting, etc. Change Healthcare has carved out a niche position in consulting / advisory services, payer services, and emerging value-based care enablement market. The company is among the top two players in the market in pharmacy benefits administration.

Organizational Structure

On March 1, 2017, McKesson Corporation and Change Healthcare (formerly HCIT Holdings) completed a transaction whereby the majority of McKesson's Technology Solutions segment ("Core MTS") and substantially all of Change Healthcare Performance (formerly Change Healthcare)'s legacy business ("Legacy CHC") established a joint venture, Change Healthcare. Prior to and immediately following the IPO offering, Change Healthcare Inc. and McKesson each hold a 50% voting interest in the joint venture, with equal representation on the joint venture's board of directors and with all major operating, investing and financial activities requiring the consent of both members.

The limited liability company agreement of the joint venture provides for a single class of membership interests, referred as "LLC Units." Prior to the IPO offering, Change Healthcare held approximately 30% of the issued and outstanding LLC Units and McKesson held approximately 70% of the outstanding LLC Units. Post-offering organizational structure (commonly referred to as an umbrella partnership C-corporation or UP-C structure), McKesson holds approximately 60% of the outstanding LLC units.

According to Change Healthcare, McKesson generally finds it advantageous, in periods prior to the Qualified McKesson Exit, to continue to hold its equity interests in an entity that is not taxable as a corporation for US federal income tax purposes. Change Healthcare does not believe that its UP-C organizational structure will give rise to any significant business or strategic benefit or detriment to the company.

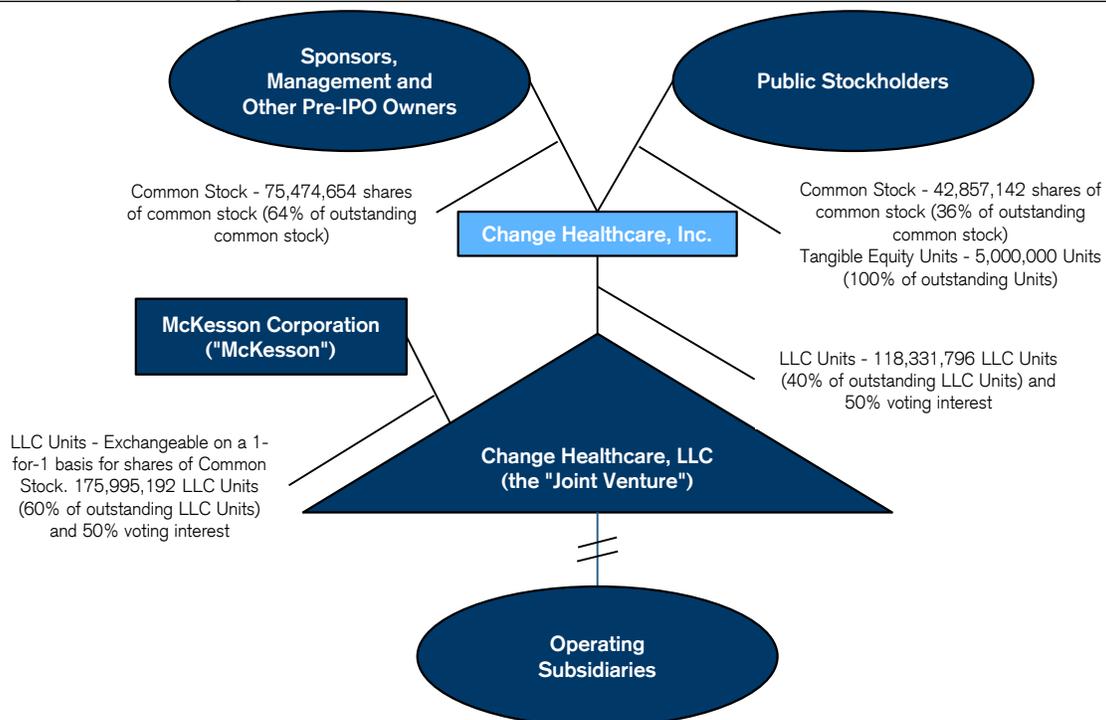
Following the 180-days expiration of the underwriter lock-up period in connection with the IPO offering, subject to the terms and subject to the conditions provided in the LLC Agreement, McKesson may, at its election, initiate and complete a spin-off or split-off transaction (or a combination of the foregoing) that would result, among other things, in the acquisition by Change Healthcare of all of McKesson's LLC Units and the issuance by Change Healthcare to McKesson and/or McKesson's shareholders of an equal number of shares of its common stock (a "Qualified McKesson Exit").

In connection with a Qualified McKesson Exit, McKesson would contribute the stock of McKesson subsidiaries that own all of McKesson's interests in the joint venture to a Delaware corporation that is McKesson's direct or indirect wholly-owned subsidiary ("SpinCo") and then would either distribute stock of SpinCo to the stockholders of McKesson as a dividend in a spin-off, commence one or more exchange offers pursuant to which McKesson will exchange stock of SpinCo for stock of McKesson held by the stockholders of McKesson or consummate one or more exchanges of stock of SpinCo for debt securities of McKesson (or a combination of the foregoing). Immediately thereafter, SpinCo would merge with and into Change Healthcare, pursuant to which the stockholders of SpinCo will be entitled to receive a number of shares of common stock of Change Healthcare equal to the number of LLC Units held by SpinCo at the effective time of the Merger.

Following a Qualified McKesson Exit, Change Healthcare LLC is expected to become a consolidated subsidiary of Change Healthcare.

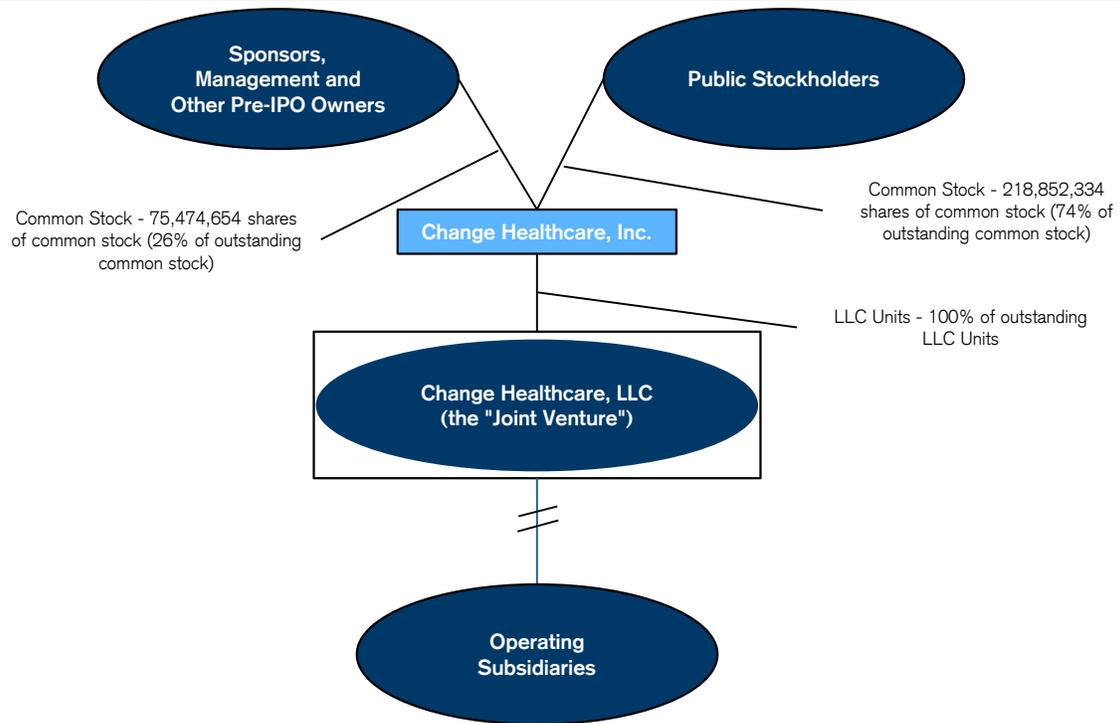
In addition, following the IPO offering, on the terms and subject to the conditions provided in the LLC Agreement, McKesson (or certain permitted transferees) now has the right from time to time to exchange its LLC Units for shares of Change Healthcare's common stock on a one-for-one basis, subject to customary conversion rate adjustments for stock splits, stock dividends and reclassifications.

Figure 9: Post-IPO Ownership Structure



Source: Company data

Figure 10: Ownership Structure Post McKesson’s Qualified Exit



Source: Company data

Initial Public Offering (IPO)

The net proceeds to Change Healthcare from its IPO (priced at \$13.00 per share) were approximately \$529 mln (or \$609 mln if the underwriters exercise in full their option to purchase additional shares of common stock) after deducting underwriting discounts and commissions. The net proceeds to Change Healthcare from the concurrent offering of the Units were approximately \$243 mln (or \$279 mln if the underwriters in the concurrent offering of the Units exercise in full their option to purchase additional Units) after deducting underwriting discounts and commissions. The company used these proceeds to pay down its term loan.

Financials

Change Healthcare's adjusted solutions revenue grew around 0.6% in FY19 (or around 1.8% excluding the Extended Care and other revenue adjustments), as the company continues to strategically position underperforming business segments for future growth. For FY20, we estimate the adjusted solutions revenue growth to remain depressed at 1.2% Y/Y (or 1.3% excluding the Extended Care and other revenue adjustments) as Change Healthcare continues to align itself to take advantage of fast-paced growth in Healthcare IT. Once fully implemented, the company's revenue should pick up in FY21 to 4.1% Y/Y growth. Even with some revenue losses in FY20, we expect Change Healthcare to post EBITDA growth of 5.6% primarily driven from the abundance of opportunities that can help push short-term productivity. In FY20, we expect the company to continue to re-align and reposition some of its underperforming business segments by shifting them to a long-term growth strategy, which is ultimately reflected in Change Healthcare estimated EBITDA growth rate of 6.6% in FY21.

Software & Analytics (S&A) Segment Financials

Change Healthcare's Core Software and Analytics revenue grew approximately 1.5% in FY19 which is slower than we estimate moving forward. We expect to see accelerated growth of 5.0% in FY20 despite a headwind of product overlaps which has resulted in a loss on the bottom line but has helped increase top-line revenue. It is important to note that there is evidence of seasonality in this business segment as the clinical review business ramps up in Q4. We expect to see Q4 FY20 revenue grow at 7.8% Y/Y. This uptick can also be seen in Q4 of 2020 adjusted EBITDA as we estimate that it will grow by \$29.1 million to \$281.1 million.

Network Solutions Segment Financials

Change Healthcare's Network Solutions revenue grew around 6.8% in FY19 as the company looks to capitalize on key drivers such as the B2B payments pushed by the data solutions business segment. We expect Change Healthcare to continue to integrate its various networks into one fully comprehensive site but do not see this in top-line growth until FY20. In FY20 we expect growth to slow at a rate of 3.1%. We assume that by this year its network integration process will help improve efficiency and bolster the networks capability but the full effects will not be seen until FY21. Once fully integrated we expect to see an improved growth rate of 3.3% which is primarily driven by the change in the actual transaction to the insight the company will provide customers. Over time we expect the B2B segments to continue to grow.

Technology-Enabled Services Segment Financials

Change Healthcare's Technology-Enabled Services revenue declined roughly 2.0% for FY19. This decline can be attributed to the realignment of the segment as the company looks to diversify its revenue stream away from the ambulatory BTO space. The company is looking to help enhance growth within the print business and we expect this to have a slight impact in FY20 of 0.2% but still expect a decline of 1.8%. In FY20 our estimate includes a \$20 million dollar contract expiration. Despite that revenue headwind, we expect to see growth of 3.6% in FY21. The growth can be attributed to the abundance of opportunities to increase productivity gains through AI and RPA.

Industry Trends

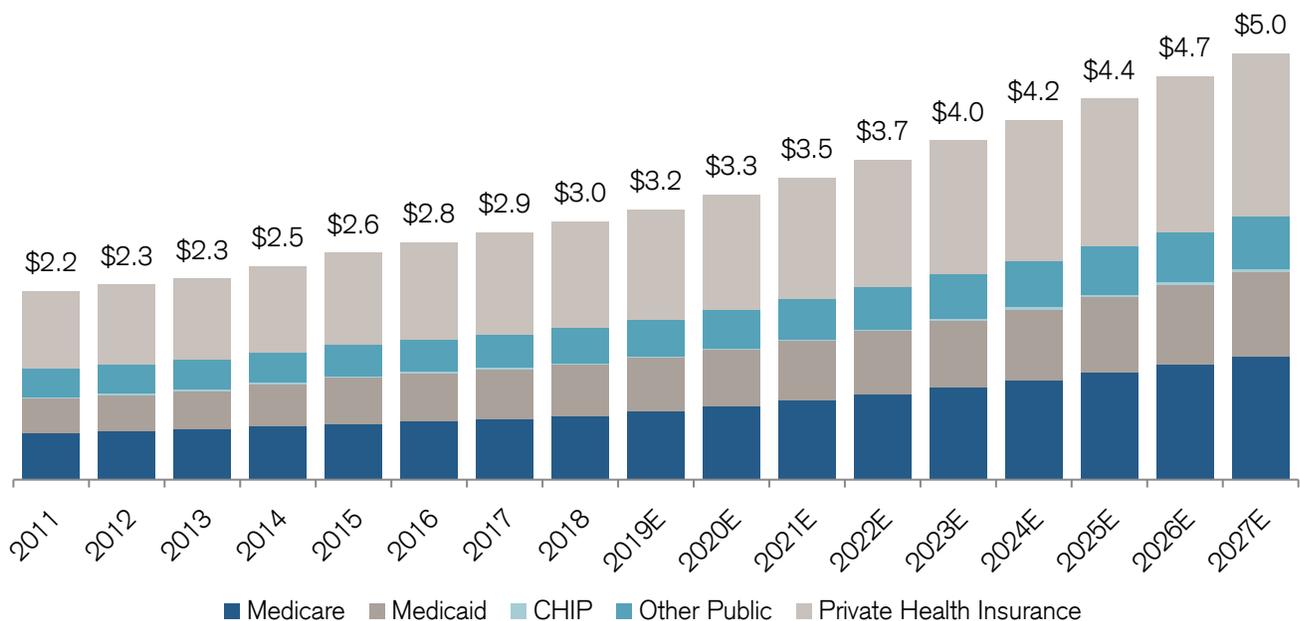
The key industry trends which support Change Healthcare’s growth prospects include: a) reducing unnecessary medical spend amidst rising healthcare costs, b) growing population of chronically ill and higher-risk patients, c) increasing adoption of value-based care and reimbursement models, d) increasing financial responsibility of patients and consumerism of healthcare services, and e) proliferation of healthcare data.

Unnecessary Medical Spending Amidst Rising Costs in U.S. Healthcare System

According to a research by the National Academy of Medicine, 30% of US healthcare spending is unnecessary, implying more than \$1 trillion of wasteful healthcare spending in 2018. Examples of wastefulness include failure to adhere to best care practices and lack of care coordination, significant variation among providers in the cost and quality, many inefficient processes that are manual, complex, frequently changing and time consuming. In addition, improper payments, according to the Office of Management and Budget, have represented approximately 10% of all Medicare and Medicaid payments since 2015. Such improper payments and fraudulent billing create costly and labor-intensive follow-up.

According to the Center for Medicare & Medicaid Services (CMS), US healthcare spending is expected to grow at a 5.6% annual growth rate, or 3.2% higher than expected inflation over the same period from 2018 to 2027. Given the significant and lasting financial burden of ongoing rising costs and unnecessary spending on society, both governmental and commercial payers and providers are increasingly focused on reducing costs attributable to administrative complexity and errors, excessive manual labor, and uncoordinated, unproductive, ineffective care the value of which is not well determined or communicated.

Figure 11: Health Care Expenditures (\$ in trillions)



Source: Company data, Center for Medicare and Medicaid Services

Growing Population of Chronically ill and Higher-Risk Patients

While the US population is expected to increase 7% from 2017 to 2027, the population of adults age 65 and older is expected to increase 34% over the same period, according to the US Census Bureau. This part of the population has the highest prevalence of chronic conditions, with average annual healthcare spending approximately three times higher than working adults and approximately five times higher than the under 18 year old demographic, according to CMS. As those older than 65 years of age access complex care at growing rates, they are also increasingly enrolling in managed care plans that bear the likelihood of healthcare utilization. For example, enrollment in Medicare Advantage is expected to increase to 45% of eligible lives by 2027, according to the Congressional Budget Office.

Additionally, government agencies are seeking to more effectively service Dual Eligibles, who are typically among the most chronically ill and disproportionately expensive beneficiaries for both Medicaid and Medicare, and promote avenues to access care in a more efficient and effective way. As the US healthcare system increasingly serves more chronically ill and higher-risk populations as the country's elderly population continues to grow, providers and payers will need tools to onboard and manage these populations, including the ability to deliver appropriate care for medically-complex patients, and the ability to document risk and outcomes to attain the appropriate reimbursement rates associated with these populations.

Increasing adoption of value-based care and reimbursement models

Both public and private sectors are shifting towards alternative payment models that are designed to incentivize value and quality throughout an "episode of care." These payment models require a high level of documentation, robust data, sophisticated payment attribution capabilities and advanced analytics that can adapt to new rules and goals to ensure compliance. Many payers and providers are still building the capabilities, expertise and administrative processes to manage these changes adequately. They are increasingly partnering with third parties to demonstrate the achievement of the outcomes required under these value-based payment models, which requires a fundamentally different skillset than has been deployed historically.

Increasing financial responsibility of patients and consumerism in healthcare

As healthcare expenditures have continued to rise, employers and health plans have shifted costs to patients through increased adoption of high-deductible health plans. Increases in patient financial responsibility require providers to obtain payment from the patient before and after the point of care. As providers become more consumer-oriented and retail in nature, they require increasingly sophisticated, dynamic and personalized solutions, which generally necessitate scale to be implemented efficiently and cost effectively. As patients are required to more out of their own pockets for healthcare, they are demanding price transparency and decision support from their health plans. Health plans are consequently partnering with third parties to provide their members with tools that enable them to assess quality and cost based on individual plan benefits. At the same time, providers seek to effectively communicate the quality and value of their services, determine patients' upfront insurance eligibility, coverage and ability to pay their portion of their healthcare bills, and simplify the payment process to improve patient experience and satisfaction.

Proliferation of healthcare data

The US government funded almost \$40 billion of incentive payments to healthcare providers between 2011 and 2017 to adopt electronic health record technology, which has resulted in 80% of physicians and 96% of hospitals in the United States having certified Electronic Health Record systems as of 2017, according to the Office of the National Coordinator for Health Information Technology. These EHRs, other digitized healthcare

data and the increasing amount of personal health data from smartphones, wearable and other devices have created unprecedented amounts of healthcare data in the United States, which is expected to grow to more than 2,300 exabytes by 2020, according to the 2014 EMC Digital Universe Study by International Data Corporation. However, healthcare data is often siloed and unstructured and has historically been difficult to understand and use by all constituents on a timely basis.

Advancements in ML and AI are making it easier to cost effectively utilize data at scale in real time to identify actionable insights that help improve outcomes and decrease cost for healthcare constituents. As healthcare data can be used more effectively, the leading technology companies will increasingly seek scaled partners like Change Healthcare to develop new software and analytics solutions that help payers and providers improve workflows to deliver higher quality care at lower cost to consumers.

Change Healthcare continues to develop data-driven solutions that can drive tangible returns for its customers.

PEERs Analysis

Figure 12: CHNG PEERs Analysis



Source: Credit Suisse

Financial Models

Figure 13: Annual Income Statement (\$ in mlns except per share)

	FY18	FY19	FY20E	FY21E	FY22E
Adjusted Solutions revenue	\$3,024.4	\$3,043.1	\$3,079.5	\$3,206.9	\$3,345.4
Postage revenue	\$274.4	\$238.6	\$244.1	\$269.1	\$293.3
Total revenue	\$3,298.8	\$3,281.7	\$3,323.6	\$3,475.9	\$3,638.7
Cost of operations	(1,390.2)	(1,340.0)	(1,259.8)	(1,272.7)	(1,289.3)
R&D Expense	(221.7)	(202.2)	(199.6)	(197.7)	(194.6)
Sales, Marketing, G&A	(749.8)	(821.1)	(787.7)	(765.1)	(774.2)
Accretion and changes in estimate with related p	49.9	(19.3)	(13.4)	(12.95)	(13.0)
Gain on Sale of the Extended Care Business	0.8	111.4	0.0	0.0	0.0
Other Income	17.2	18.3	16.0	16.0	16.0
Customer Postage Expense	(274.4)	(238.6)	(244.1)	(269.1)	(293.3)
GAAP EBITDA	\$730.6	\$790.3	\$834.9	\$974.5	\$1,090.5
D&A	(278.4)	(278.0)	(295.1)	(298.5)	(300.5)
Amortization of capitalized software developed fo	(18.3)	(14.7)	(34.1)	(67.4)	(71.4)
GAAP EBIT	\$433.9	\$497.6	\$505.8	\$608.6	\$718.6
Interest Expense	(292.5)	(325.4)	(308.3)	(283.7)	(260.4)
Pre-Tax Income	\$141.5	\$172.2	\$197.4	\$324.9	\$458.2
Income Tax Expense	51.8	(4.5)	(14.7)	(78.0)	(110.0)
GAAP Net Income	\$193.2	\$167.7	\$182.8	\$246.9	\$348.2
Non-Recurring Expenses (Income) for Adjusted EBITDA Calculation					
Total Non-Recurring Adjustments	213.4	144.7	155.4	86.2	43.9
Adjusted EBITDA	\$944.0	\$935.0	\$990.4	\$1,060.6	\$1,134.4
Adjusted EBIT	\$647.3	\$642.3	\$661.2	\$694.8	\$762.5
After Tax Impact of Non-recurring items	256.6	311.0	267.4	222.2	163.9
Adjusted Net Income	\$449.9	\$478.7	\$450.2	\$469.1	\$512.1
Diluted Shares Outstanding			303.4	325.9	331.9
GAAP EPS			\$0.60	\$0.76	\$1.05
Adjusted EPS			\$1.48	\$1.44	\$1.54
Margins/Expense Analysis (As a % of Adj Soltns Rev)					
Cost of Operations	46.0%	44.0%	40.9%	39.7%	38.5%
R&D Expense	7.3%	6.6%	6.5%	6.2%	5.8%
Sales, marketing, G&A	24.8%	27.0%	25.6%	23.9%	23.1%
EBITDA Margin	24.2%	26.0%	27.1%	30.4%	32.6%
Adjusted EBITDA Margin	31.2%	30.7%	32.2%	33.1%	33.9%
Pre-Tax Margin	4.7%	5.7%	6.4%	10.1%	13.7%
Effective Tax Rate	NM	NM	7.4%	24.0%	24.0%
Adjusted Net Margin	14.9%	15.7%	14.6%	14.6%	15.3%
Growth Analysis					
Adjusted Solutions revenue		0.6%	1.2%	4.1%	4.3%
Postage revenue		(13.0%)	2.3%	10.2%	9.0%
Total Revenue		(0.5%)	1.3%	4.6%	4.7%
Adjusted EBITDA Growth		(1.0%)	5.9%	7.1%	7.0%
Adjusted Net Income Growth		6.4%	(6.0%)	4.2%	9.2%
Adjusted EPS Growth				(3.0%)	7.2%

Source: Company data, Credit Suisse Estimates

Figure 14: Annual Balance Sheet Statement (\$ in mlns)

	FY18	FY19	FY20E	FY21E	FY22E
<i>Assets</i>					
Cash	\$50.0	\$48.9	\$242.3	\$359.4	\$441.2
Accounts Receivable	705.5	759.5	\$706.8	\$738.0	\$769.9
Prepaid Expenses & Other Current	146.2	172.1	\$154.0	\$160.3	\$167.3
Total Current Assets	\$901.7	\$980.5	\$1,103.0	\$1,257.7	\$1,378.4
PP&E	167.5	197.3	164.0	115.6	62.7
Intangibles	1,454.8	1,320.2	1,185.2	1,053.7	938.7
Goodwill	3,344.8	3,284.3	3,284.3	3,284.3	3,284.3
Other Non-Current Assets, Net	332.0	422.0	559.0	608.0	653.0
Total Assets	\$6,200.9	\$6,204.1	\$6,295.4	\$6,319.3	\$6,317.0
<i>Liabilities & Equity</i>					
Accounts Payable	84.1	98.6	\$82.5	\$96.2	\$93.7
Accrued Expenses	329.3	316.2	\$323.3	\$352.8	\$374.7
Deferred Revenues	493.9	437.6	\$431.1	\$465.0	\$495.1
Due to Related Party	8.7	34.6	0.0	0.0	0.0
Liabilities of business held for sale	0.0	0.0	0.0	0.0	0.0
Current Portion of LTD	53.4	2.8	2.0	2.0	2.0
Total Current Liabilities	\$969.5	\$889.8	\$839.0	\$916.0	\$965.5
LTD, excluding Current Portio	5,867.5	5,787.2	4,939.7	4,639.7	4,239.7
Tax Receivable Agreement Obligation	223.2	212.7	198.7	188.7	178.7
Deferred Tax Liability	112.7	106.1	116.1	126.1	136.1
Other Long-Term Liabilities	94.2	113.2	113.2	113.2	113.2
Equity	(1,066.2)	(904.8)	88.7	335.7	683.9
Total Liabilities & Equity	\$6,200.9	\$6,204.1	\$6,295.4	\$6,319.3	\$6,317.0

Source: Company data, Credit Suisse Estimates

Figure 15: Annual Cash Flow Statement (\$ in mlns)

	FY18	FY19	FY20E	FY21E	FY22E
Net Income	\$192.4	\$176.7	\$182.8	\$246.9	\$348.2
D&A	278.4	278.0	295.1	298.5	300.5
Change in Working Capital	(103.1)	(125.3) [▼]	\$20.8	\$39.3	\$10.7
Other	(42.9)	(41.7) [▼]	(2.0)	82.5	70.0
Operating Cash Flow	\$324.8	\$287.7	\$496.7	\$667.2	\$729.4
Capital Expenditures	(166.6)	(247.0)	(261.8)	(\$250.1)	(\$247.6)
(Acquisitions) / Divestitures	(94.5)	159.9	0.0	0.0	0.0
Other	0.4	(18.6)	0.0	0.0	0.0
Cash from Investing Activities	(\$260.7)	(\$105.7)	(\$261.8)	(\$250.1)	(\$247.6)
Debt Paydown	(51.0)	(153.0)	(848.3)	(300.0)	(400.0)
Equity Issuance	0.0	0.0	810.7	0.0	0.0
Other	(146.5)	(29.1) [▼]	(4.0)	0.0	0.0
Cash from Financing Activities	(\$197.5)	(\$182.1)	(\$41.5)	(\$300.0)	(\$400.0)
Effect of exchange rate changes on cash	(4.7)	(1.0)	0.0	0.0	0.0
Net Increase (Decrease) in Cash and Cash Equival	(\$138.1)	(\$1.1)	\$193.4	\$117.1	\$81.8
Cash and Cash Equivalents at Beginning of Period	188.1	50.0	48.9	242.3	359.4
Cash and Cash Equivalents at End of Period	\$50.0	\$48.9	\$242.3	\$359.4	\$441.2

Source: Company data, Credit Suisse Estimates

Companies Mentioned (Price as of 18-Jul-2019)

- Allscripts Healthcare Solutions Inc. (MDRX.OQ, \$11.24)
- Anthem, Inc. (ANTM.N, \$304.57)
- CVS Health (CVS.N, \$56.5)
- Centene Corporation (CNC.N, \$53.17)
- Cerner Corporation (CERN.OQ, \$74.0)
- Change Healthcare (CHNG.OQ, \$13.62, OUTPERFORM[V], TP \$18.0)
- Cigna Corporation (CI.N, \$176.94)
- Cognizant Technology Solutions Corp. (CTSH.OQ, \$65.93)
- General Electric (GE.N, \$10.06)
- HMS Holdings Corp (HMSY.OQ, \$33.61)
- HealthEquity (HQY.OQ, \$76.43)
- Humana Inc. (HUM.N, \$283.33)
- Inovalon Hldg (INOV.OQ, \$14.84)
- International Business Machines (IBM.N, \$149.63)
- Premier Inc (PINC.OQ, \$39.71)
- Quality Systems, Inc (NXGN.OQ, \$20.22)
- R1 RCM (RCM.OQ, \$13.08)
- Tabula Rasa (TRHC.OQ, \$55.14)
- Teladoc Health (TDOC.N, \$68.53)
- UnitedHealth Group Inc. (UNH.N, \$260.6)
- Walgreens Boots Alliance (WBA.OQ, \$54.82)
- WellCare Health Plans, Inc. (WCG.N, \$288.4)
- eHealth (EHTH.OQ, \$87.58)

Disclosure Appendix

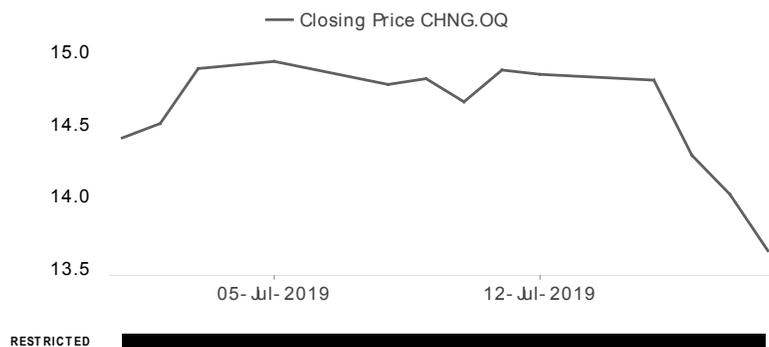
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3-Year Price and Rating History for Change Healthcare (CHNG.OQ)

CHNG.OQ	Closing Price	Target Price	
Date	(US\$)	(US\$)	Rating
01-Jul-19	14.40		R

* Asterisk signifies initiation or assumption of coverage.



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Outperform (O) : The stock's total return is expected to outperform the relevant benchmark* over the next 12 months.

Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.

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Underperform/Sell*	13%	(23% banking clients)
Restricted	2%	

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Target Price and Rating

Valuation Methodology and Risks: (12 months) for Change Healthcare (CHNG.OQ)

Method: Given the lack of trading history, we benchmark CHNG shares with its closest peers, CERN, which is trading at roughly 12.0x 2021 CY EBITDA consensus. However, given FY20 being a transition year for CHNG and its relatively high leverage, we believe CHNG shares should trade at roughly 20% discount to CERN shares, yielding a PT EV/EBITDA valuation multiple of 9.5x on our 2021 EBITDA estimate and a PT of \$18.

Risk: Risks to our Outperform rating and PT include current investments not yielding desired results, and inability to deleverage its balance sheet.

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This research report is authored by:

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