

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **October 31, 2020**
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: **001-36568**

HEALTHEQUITY, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

52-2383166

(I.R.S. Employer
Identification Number)

**15 West Scenic Pointe Drive
Suite 100**

Draper, Utah 84020
(Address of principal executive offices) (Zip code)

(801) 727-1000
(Registrant's telephone Number, including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, par value \$0.0001 per share	HQY	The NASDAQ Global Select Market

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth Company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 25, 2020, there were 76,990,646 shares of the registrant's common stock outstanding.

HealthEquity, Inc. and subsidiaries

Form 10-Q quarterly report

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Part I. Financial information
Item 1. Financial statements

HealthEquity, Inc. and subsidiaries
Condensed consolidated balance sheets

(in thousands, except par value)	October 31, 2020	January 31, 2020
	(unaudited)	
Assets		
Current assets		
Cash and cash equivalents	\$ 299,356	\$ 191,726
Accounts receivable, net of allowance for doubtful accounts of \$3,458 and \$1,216 as of October 31, 2020 and January 31, 2020, respectively	64,291	70,863
Other current assets	32,383	34,711
Total current assets	396,030	297,300
Property and equipment, net	31,774	33,486
Operating lease right-of-use assets	92,314	83,178
Intangible assets, net	776,311	783,279
Goodwill	1,326,793	1,332,631
Deferred tax asset	21	18
Other assets	34,019	35,089
Total assets	\$ 2,657,262	\$ 2,564,981
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$ 6,746	\$ 3,980
Accrued compensation	34,839	50,121
Accrued liabilities	33,380	46,372
Current portion of long-term debt	62,500	39,063
Operating lease liabilities	13,894	12,401
Total current liabilities	151,359	151,937
Long-term liabilities		
Long-term debt, net of issuance costs	938,558	1,181,615
Operating lease liabilities, non-current	76,666	68,017
Other long-term liabilities	11,429	2,625
Deferred tax liability	123,993	130,492
Total long-term liabilities	1,150,646	1,382,749
Total liabilities	1,302,005	1,534,686
Commitments and contingencies (see Note 6)		
Stockholders' equity		
Preferred stock, \$0.0001 par value, 100,000 shares authorized, no shares issued and outstanding as of October 31, 2020 and January 31, 2020, respectively	—	—
Common stock, \$0.0001 par value, 900,000 shares authorized, 76,951 and 71,051 shares issued and outstanding as of October 31, 2020 and January 31, 2020, respectively	8	7
Additional paid-in capital	1,140,268	818,774
Accumulated earnings	214,981	211,514
Total stockholders' equity	1,355,257	1,030,295
Total liabilities and stockholders' equity	\$ 2,657,262	\$ 2,564,981

See accompanying notes to condensed consolidated financial statements.

HealthEquity, Inc. and subsidiaries
Condensed consolidated statements of operations and
comprehensive income (loss) (unaudited)

(in thousands, except per share data)	Three months ended October 31,		Nine months ended October 31,	
	2020	2019	2020	2019
Revenue				
Service revenue	\$ 104,562	\$ 87,620	\$ 319,638	\$ 140,710
Custodial revenue	48,544	46,972	142,352	132,538
Interchange revenue	26,245	22,526	83,411	57,545
Total revenue	179,351	157,118	545,401	330,793
Cost of revenue				
Service costs	65,936	52,278	202,195	92,672
Custodial costs	4,762	4,384	14,805	12,716
Interchange costs	4,095	4,421	13,985	13,177
Total cost of revenue	74,793	61,083	230,985	118,565
Gross profit	104,558	96,035	314,416	212,228
Operating expenses				
Sales and marketing	12,880	12,654	36,502	30,015
Technology and development	30,758	23,511	92,490	46,061
General and administrative	22,099	19,222	61,590	37,193
Amortization of acquired intangible assets	19,126	13,051	56,905	16,036
Merger integration	8,193	17,675	31,328	20,459
Total operating expenses	93,056	86,113	278,815	149,764
Income from operations	11,502	9,922	35,601	62,464
Other expense				
Interest expense	(6,952)	(10,225)	(28,110)	(10,355)
Other expense, net	(421)	(30,949)	(2,009)	(8,347)
Total other expense	(7,373)	(41,174)	(30,119)	(18,702)
Income (loss) before income taxes	4,129	(31,252)	5,482	43,762
Income tax provision (benefit)	2,340	(9,918)	2,015	3,908
Net income (loss) and comprehensive income (loss)	\$ 1,789	\$ (21,334)	\$ 3,467	\$ 39,854
Net income (loss) per share:				
Basic	\$ 0.02	\$ (0.30)	\$ 0.05	\$ 0.61
Diluted	\$ 0.02	\$ (0.30)	\$ 0.05	\$ 0.59
Weighted-average number of shares used in computing net income (loss) per share:				
Basic	76,701	70,524	73,358	65,727
Diluted	77,845	70,524	74,665	67,150

See accompanying notes to condensed consolidated financial statements.

HealthEquity, Inc. and subsidiaries
Condensed consolidated statements of stockholders' equity (unaudited)

(in thousands)	Three months ended October 31,		Nine months ended October 31,	
	2020	2019	2020	2019
Total stockholders' equity, beginning balance	\$ 1,340,336	\$ 1,017,031	\$ 1,030,295	\$ 477,079
Common stock:				
Beginning balance	8	7	7	6
Issuance of common stock upon exercise of stock options, and for restricted stock	—	—	—	—
Other issuance of common stock	—	—	1	1
Ending balance	8	7	8	7
Additional paid-in capital:				
Beginning balance	1,127,136	783,986	818,774	305,223
Issuance of common stock upon exercise of stock options, and for restricted stock	1,651	712	4,402	7,363
Other issuance of common stock	2	3,776	286,779	462,270
Stock-based compensation	11,479	17,576	30,313	31,194
Ending balance	1,140,268	806,050	1,140,268	806,050
Accumulated earnings				
Beginning balance	213,192	233,038	211,514	171,850
Net income (loss)	1,789	(21,334)	3,467	39,854
Ending balance	214,981	211,704	214,981	211,704
Total stockholders' equity, ending balance	\$ 1,355,257	\$ 1,017,761	\$ 1,355,257	\$ 1,017,761

See accompanying notes to condensed consolidated financial statements.

HealthEquity, Inc. and subsidiaries
Condensed consolidated statements of cash flows (unaudited)

(in thousands)	Nine months ended October 31,	
	2020	2019
Cash flows from operating activities:		
Net income	\$ 3,467	\$ 39,854
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	85,485	28,791
Stock-based compensation	30,313	31,194
Amortization of debt issuance costs	3,818	1,138
Gains on marketable equity securities	—	(27,570)
Other non-cash items	1,727	139
Deferred taxes	(973)	690
Changes in operating assets and liabilities:		
Accounts receivable	8,063	(1,901)
Other assets	3,309	(4,863)
Operating lease right-of-use assets	8,344	3,340
Accrued compensation	(15,251)	(8,012)
Accounts payable, accrued liabilities, and other current liabilities	(7,936)	14,179
Operating lease liabilities, non-current	(8,361)	(2,859)
Other long-term liabilities	8,712	(50)
Net cash provided by operating activities	120,717	74,070
Cash flows from investing activities:		
Purchases of property and equipment	(11,388)	(5,180)
Purchases of software and capitalized software development costs	(37,242)	(17,232)
Acquisition of intangible member assets	(28,100)	(9,070)
Purchases of marketable securities	—	(53,845)
Acquisitions, net of cash acquired	—	(1,630,066)
Net cash used in investing activities	(76,730)	(1,715,393)
Cash flows from financing activities:		
Proceeds from follow-on equity offering, net of payments for offering costs	286,779	458,495
Principal payments on long-term debt	(223,438)	—
Settlement of client-held funds obligation, net	(4,189)	(230,928)
Proceeds from exercise of common stock options	4,491	7,342
Proceeds from long-term debt	—	1,250,000
Payment of debt issuance costs	—	(30,504)
Net cash provided by financing activities	63,643	1,454,405
Increase (decrease) in cash and cash equivalents	107,630	(186,918)
Beginning cash and cash equivalents	191,726	361,475
Ending cash and cash equivalents	\$ 299,356	\$ 174,557

See accompanying notes to condensed consolidated financial statements.

HealthEquity, Inc. and subsidiaries
Condensed consolidated statements of cash flows (unaudited) (continued)

(in thousands)	Nine months ended October 31,	
	2020	2019
Supplemental cash flow data:		
Interest expense paid in cash	\$ 22,849	\$ 249
Income taxes paid in cash, net of refunds received	1,053	9,127
Supplemental disclosures of non-cash investing and financing activities:		
Property and equipment included in accounts payable or accrued liabilities	\$ 167	\$ 168
Software and capitalized software development costs included in accounts payable, accrued liabilities, or accrued compensation	1,346	316
Intangible member assets included in accounts payable or accrued liabilities	289	(151)
Decrease in goodwill due to measurement period adjustments, net	5,838	—
Exercise of common stock options receivable	89	21
Equity-based acquisition consideration	—	3,776

See accompanying notes to condensed consolidated financial statements.

HealthEquity, Inc. and subsidiaries

Notes to condensed consolidated financial statements

Note 1. Summary of business and significant accounting policies

Business

HealthEquity, Inc. ("HealthEquity" or the "Company") was incorporated in the state of Delaware on September 18, 2002. HealthEquity is a leader in administering health savings accounts ("HSAs") and complementary consumer-directed benefits ("CDBs"), which empower consumers to access tax-advantaged healthcare savings while also providing corporate tax advantages for employers.

Principles of consolidation

The condensed consolidated financial statements include the accounts of HealthEquity and its direct and indirect subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Basis of presentation

The accompanying condensed consolidated financial statements as of October 31, 2020 and for the three and nine months ended October 31, 2020 and 2019 are unaudited and have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and the applicable rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. In the opinion of management, the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the interim periods. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2020. The fiscal year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

Follow-on equity offering

In July 2020, the Company closed a follow-on public offering of 5,290,000 shares of common stock at a public offering price of \$56.00 per share, less the underwriters' discount. The Company received net proceeds of approximately \$286.8 million after deducting underwriting discounts and commissions of approximately \$8.9 million and other offering expenses of approximately \$0.6 million. The Company used \$200.0 million of such proceeds to repay debt under its term loan facility.

Significant accounting policies

There have been no material changes in the Company's significant accounting policies as compared to the significant accounting policies described in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2020.

Recently adopted accounting pronouncements

In June 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-13, *Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments*, which requires financial assets measured at amortized cost be presented at the net amount expected to be collected. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company adopted the new standard as of February 1, 2020 using the modified retrospective transition method. The adoption of this standard did not have a material effect on the Company's condensed consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement* ("ASU 2018-13"), which amends ASC 820, "Fair Value Measurement." ASU 2018-13 modifies the disclosure requirements for fair value measurements by removing, modifying and adding certain disclosures. This ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The Company adopted the new standard as of February 1, 2020. The adoption of this standard did not have a material effect on the Company's condensed consolidated financial statements.

In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes* as part of its overall simplification initiative to reduce costs and complexity of applying accounting standards while maintaining or improving the usefulness of the information provided to users of financial statements. The Company adopted the new standard as of February 1, 2020. The Company retrospectively adopted the provision related to the classification of taxes partially based on income, and prospectively adopted the provisions related to intraperiod tax allocation and interim recognition of enactment of tax laws. The adoption of this standard did not have a material effect on the Company's current- or prior-period condensed consolidated financial statements.

Note 2. Net income (loss) per share

The following table sets forth the computation of basic and diluted net income (loss) per share:

(in thousands, except per share data)	Three months ended October 31,		Nine months ended October 31,	
	2020	2019	2020	2019
Numerator (basic and diluted):				
Net income (loss)	\$ 1,789	\$ (21,334)	\$ 3,467	\$ 39,854
Denominator (basic):				
Weighted-average common shares outstanding	76,701	70,524	73,358	65,727
Denominator (diluted):				
Weighted-average common shares outstanding	76,701	70,524	73,358	65,727
Weighted-average dilutive effect of stock options and restricted stock units	1,144	—	1,307	1,423
Diluted weighted-average common shares outstanding	77,845	70,524	74,665	67,150
Net income (loss) per share:				
Basic	\$ 0.02	\$ (0.30)	\$ 0.05	\$ 0.61
Diluted	\$ 0.02	\$ (0.30)	\$ 0.05	\$ 0.59

For the three months ended October 31, 2020 and 2019, approximately 1.0 million and 3.2 million shares, respectively, attributable to stock options and restricted stock units were excluded from the calculation of diluted earnings per share as their inclusion would have been anti-dilutive.

For the nine months ended October 31, 2020 and 2019, approximately 0.6 million and 0.3 million shares, respectively, attributable to stock options and restricted stock units were excluded from the calculation of diluted earnings per share as their inclusion would have been anti-dilutive.

Note 3. Business combination

Acquisition of WageWorks

On August 30, 2019, the Company closed the acquisition (the "Acquisition") of WageWorks, Inc. ("WageWorks") for \$51.35 per share in cash, or approximately \$2.0 billion to WageWorks stockholders. The Company financed the transaction through a combination of \$816.9 million cash on hand plus net borrowings of approximately \$1.22 billion, after deducting lender fees of approximately \$30.5 million, under a term loan facility.

The Acquisition was accounted for under the acquisition method of accounting for business combinations. Consideration paid was allocated to the tangible and intangible assets acquired and liabilities assumed based on their fair values as of the Acquisition date. The initial allocation of the consideration paid was based on a preliminary valuation and was subject to adjustment during the measurement period (up to one year from the Acquisition date). The purchase price allocation was finalized in the third quarter of fiscal 2021.

The following table summarizes the Company's allocation of the consideration paid in the Acquisition:

(in millions)	Initial Allocation	Adjustments	Updated Allocation
Cash and cash equivalents	\$ 406.8	\$ (14.5)	\$ 392.3
Other current assets	56.5	2.5	59.0
Property, plant, and equipment	26.6	—	26.6
Operating lease right-of-use assets	42.5	—	42.5
Intangible assets	715.3	—	715.3
Goodwill	1,330.5	(8.4)	1,322.1
Other assets	5.9	—	5.9
Client-held funds obligation	(237.5)	17.2	(220.3)
Other current liabilities	(69.1)	(3.3)	(72.4)
Other long-term liabilities	(26.7)	—	(26.7)
Deferred tax liability	(128.7)	6.5	(122.2)
Total consideration paid	\$ 2,122.1	\$ —	\$ 2,122.1

Adjustments to the initial allocation were based on more detailed information obtained about the specific assets acquired, liabilities assumed, and tax-related matters.

Pro forma information

The unaudited pro forma results presented below include the effects of the Acquisition as if it had been consummated as of February 1, 2018, with adjustments to give effect to pro forma events that are directly attributable to the Acquisition, which include adjustments related to the amortization of acquired intangible assets, interest income and expense, and depreciation.

The unaudited pro forma results do not reflect any operating efficiencies or potential cost savings from the integration of WageWorks. Accordingly, these unaudited pro forma results are presented for informational purposes only and are not necessarily indicative of what the actual results of operations of the combined company would have been if the Acquisition had occurred at the beginning of the period presented, nor are they indicative of future results of operations. The estimated pro forma revenue and net income (loss) include the alignment of accounting policies, the effect of fair value adjustments related to the Acquisition, associated tax effects and the impact of the borrowings to finance the Acquisition and related expenses.

(in thousands)	Three months ended October 31, 2019	Nine months ended October 31, 2019
Revenue	\$ 194,450	\$ 598,815
Net income (loss)	\$ (3,286)	\$ 34,559

Note 4. Supplemental financial statement information

Selected condensed consolidated balance sheet and condensed consolidated statement of operations and comprehensive income components consist of the following:

Property and equipment

Property and equipment consisted of the following as of October 31, 2020 and January 31, 2020:

(in thousands)	October 31, 2020	January 31, 2020
Leasehold improvements	\$ 22,310	\$ 19,240
Furniture and fixtures	9,219	7,929
Computer equipment	27,378	22,074
Property and equipment, gross	58,907	49,243
Accumulated depreciation	(27,133)	(15,757)
Property and equipment, net	\$ 31,774	\$ 33,486

Depreciation expense for the three months ended October 31, 2020 and 2019 was \$4.0 million and \$3.6 million, respectively, and \$12.0 million and \$5.4 million for the nine months ended October 31, 2020 and 2019, respectively.

Contract balances

The Company does not recognize revenue in advance of invoicing its customers and therefore has no related contract assets. The Company records a receivable when revenue is recognized prior to payment and the Company has unconditional right to payment. Alternatively, when payment precedes the related services, the Company records a contract liability, or deferred revenue, until its performance obligations are satisfied. As of October 31, 2020 and January 31, 2020, the balance of deferred revenue was \$7.0 million and \$3.7 million, respectively. The balances are related to cash received in advance for an interchange revenue arrangement, other up-front fees and other commuter deferred revenue, and are generally recognized within twelve months, with the exception of the interchange arrangement, which is recognized over a term of approximately ten years. During the three and nine months ended October 31, 2020, approximately \$0.4 million and \$2.2 million of revenue, respectively, was recognized that was included in the balance of deferred revenue as of January 31, 2020.

Leases

The components of operating lease costs were as follows:

(in thousands)	Three months ended October 31,		Nine months ended October 31,	
	2020	2019	2020	2019
Operating lease expense	\$ 3,777	3,354	12,297	5,515
Sublease income	(450)	(249)	(1,349)	(249)
Net operating lease expense	\$ 3,327	\$ 3,105	\$ 10,948	\$ 5,266

Supplemental cash flow information related to the Company's operating leases was as follows:

(in thousands)	Nine months ended October 31,	
	2020	2019
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$ 9,739	\$ 4,575
Operating lease right-of-use assets obtained in exchange for new operating lease obligations	\$ 17,480	\$ 34,394

Other expense, net

Other expense, net, consisted of the following:

(in thousands)	Three months ended October 31,		Nine months ended October 31,	
	2020	2019	2020	2019
Interest income	\$ 174	\$ 2,046	\$ 850	\$ 5,273
Gain on equity securities	—	285	—	27,570
Acquisition costs	(13)	(32,932)	(79)	(40,712)
Other expense	(582)	(348)	(2,780)	(478)
Total other expense, net	\$ (421)	\$ (30,949)	\$ (2,009)	\$ (8,347)

Note 5. Intangible assets and goodwill**Intangible assets**

The gross carrying amount and associated accumulated amortization of intangible assets were as follows as of October 31, 2020 and January 31, 2020:

(in thousands)	October 31, 2020	January 31, 2020
Amortizable intangible assets:		
Software and software development costs	\$ 116,206	\$ 76,221
Acquired HSA portfolios	121,159	92,770
Acquired customer relationships	601,381	601,381
Acquired developed technology	96,925	96,925
Acquired trade names	12,300	12,300
Amortizable intangible assets, gross	947,971	879,597
Accumulated amortization	(172,276)	(98,851)
Total amortizable intangible assets, net	775,695	780,746
Acquired in process software development costs	616	2,533
Total intangible assets, net	\$ 776,311	\$ 783,279

During the three months ended October 31, 2020 and 2019, the Company expensed a total of \$10.5 million and \$6.2 million, respectively, and \$31.1 million and \$13.8 million for the nine months ended October 31, 2020 and 2019, respectively, in software development costs primarily related to the post-implementation and operation stages of its proprietary software.

Amortization expense for the three months ended October 31, 2020 and 2019 was \$25.3 million and \$15.7 million, respectively, and \$73.5 million and \$23.6 million for the nine months ended October 31, 2020 and 2019, respectively.

Goodwill

During the three and nine months ended October 31, 2020, goodwill decreased by \$7.0 million and \$5.8 million, respectively, due to measurement period adjustments related to the Acquisition of WageWorks.

Note 6. Commitments and contingencies**Commitments**

The Company's principal commitments consist of a term loan facility, operating lease obligations for office space, data storage facilities, and other leases, a processing services agreement with a vendor, and contractual commitments related to network infrastructure, equipment, and certain maintenance agreements under long-term, non-cancelable commitments. Except for the \$200 million principal prepayment on our term loan facility, there were no material changes during the three and nine months ended October 31, 2020, outside of the ordinary course of business, in our commitments from those disclosed in our Annual Report on Form 10-K for the fiscal year ended January 31, 2020.

Contingencies

In the normal course of business, the Company enters into contracts and agreements that contain a variety of representations and warranties and provide for general indemnifications. The Company's exposure under these agreements is unknown because it involves claims that may be made against the Company in the future, but have not yet been made. The Company accrues a liability for such matters when it is probable that future expenditures will be made and such expenditures can be reasonably estimated.

Legal matters

WageWorks is pursuing affirmative claims against the Office of Personnel Management ("OPM") to obtain payment for services provided by WageWorks between March 1, 2016 and August 31, 2016 pursuant to its contract with OPM. In connection with WageWorks' claims against OPM, OPM has also claimed that an erroneous statement in a certificate signed by a former executive officer constituted a violation of the False Claims Act and moved to dismiss part of WageWorks' claim against OPM as a result. As with all legal proceedings, no assurance can be provided as to the outcome of these matters or if WageWorks or OPM will be successful.

On March 9, 2018, a putative class action was filed in the U.S. District Court for the Northern District of California (the "Securities Class Action"). On May 16, 2019, a consolidated amended complaint was filed by the lead plaintiffs asserting claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, against WageWorks, its former Chief Executive Officer and its former Chief Financial Officer on behalf of purchasers of WageWorks common stock between May 6, 2016 and March 1, 2018. The complaint also alleges claims under the Securities Act of 1933, as amended, arising from WageWorks' June 19, 2017 common stock offering against those same defendants, as well as the members of its board of directors at the time of that offering.

On June 22, 2018 and September 6, 2018, two derivative lawsuits were filed against certain of WageWorks' former officers and directors and WageWorks (as nominal defendant) in the Superior Court of the State of California, County of San Mateo. The actions were consolidated. On July 23, 2018, a similar derivative lawsuit was filed against certain former WageWorks' officers and directors and WageWorks (as nominal defendant) in the U.S. District Court for the Northern District of California (together, the "Derivative Suits"). The allegations in the Derivative Suits relate to substantially the same facts as those underlying the Securities Class Action described above. The plaintiffs seek unspecified damages and fees and costs.

Plaintiffs in the Superior Court action filed an amended consolidated complaint on October 28, 2019, naming as defendants certain former officers and directors of WageWorks and alleging a direct claim of "inseparable fraud/breach of fiduciary duty" on behalf of a class. WageWorks was not named as a party in that complaint. On June 24, 2020, the court granted the defendants' motion to dismiss the amended complaint. The plaintiffs subsequently filed a notice of appeal.

WageWorks voluntarily contacted the San Francisco office of the SEC Division of Enforcement regarding the restatement of WageWorks' financial statements and related independent investigation. WageWorks is providing information and documents to the SEC and continues to cooperate with the SEC's investigation into these matters. The U.S. Attorney's Office for the Northern District of California also opened an investigation. WageWorks has provided documents and information to the U.S. Attorney's Office and continues to cooperate with any inquiries by the U.S. Attorney's Office regarding the matter.

WageWorks previously entered into indemnification agreements with its former directors and officers and, pursuant to these indemnification agreements, is covering the defense of its former directors and officers in the legal proceedings described above.

The Company and its subsidiaries are involved in various other litigation, governmental proceedings and claims, not described above, that arise in the normal course of business. While it is not possible to determine the ultimate outcome or the duration of such litigation, governmental proceedings or claims, the Company believes, based on current knowledge, that such litigation, proceedings and claims will not have a material impact on the Company's financial position, results of operations and cash flows for the period.

The Company maintains liability insurance coverage that is intended to cover the legal matters described above; however, it is possible that claims may be denied by our insurance carriers or could exceed the amount of our applicable insurance coverage, we may be required by our insurance carriers to contribute to the payment of claims, and our insurance coverage may not continue to be available to us on acceptable terms or in sufficient amounts.

As required under GAAP, the Company records a provision for contingent losses when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Based on currently available information, the Company does not believe that any liabilities relating to these matters are probable or that the amount of any resulting loss is estimable. However, litigation is subject to inherent uncertainties and the Company's view of these matters may change in the future. Were an unfavorable outcome to occur, there exists the possibility of a material adverse impact on the Company's financial position, results of operations and cash flows for the period in which the unfavorable outcome occurs, and potentially in future periods.

Note 7. Income taxes

The Company follows FASB Accounting Standards Codification 740-270, *Income Taxes - Interim Reporting*, for the computation and presentation of its interim period tax provision. Accordingly, management estimated the effective annual tax rate and applied this rate to the year-to-date pre-tax book income to determine the interim benefit or provision for income taxes. For the three and nine months ended October 31, 2020, the Company recorded income tax expense of \$2.3 million and \$2.0 million, respectively. This resulted in an effective income tax expense rate of 56.7% and 36.8% for the three and nine months ended October 31, 2020, respectively, compared with an effective income tax benefit rate of 31.7% and an effective income tax expense rate of 8.9% for the three and nine months ended October 31, 2019, respectively. For the three and nine months ended October 31, 2020 and 2019, the net

impact of discrete tax items caused a 6.0 percentage point expense and a 9.6 percentage point benefit and a 1.1 and 8.7 percentage point benefit, respectively, to the effective income tax rate primarily due to the excess tax benefit on stock-based compensation expense and return-to-provision adjustments, which were partially offset by state apportionment changes recognized in the provision for income taxes relative to pre-tax book income. Due to significantly lower pre-tax book income during the nine months ended October 31, 2020, discrete items had a greater impact on the effective income tax rate than during the nine months ended October 31, 2019.

As of October 31, 2020 and January 31, 2020, the Company's total gross unrecognized tax benefit was \$10.0 million and \$9.4 million, respectively. As of October 31, 2020 and January 31, 2020, a net unrecognized tax benefit of \$0.5 million was recorded in the condensed consolidated balance sheets. If recognized, \$9.2 million of the total gross unrecognized tax benefits would affect the Company's effective tax rate as of October 31, 2020.

The Company files income tax returns with U.S. federal and state taxing jurisdictions and is currently under examination with the state of Texas. As a result of the Company's net operating loss carryforwards and tax credit carryforwards, the Company remains subject to examination by one or more jurisdictions for tax years after 2000.

Note 8. Indebtedness

As of October 31, 2020, long-term debt consisted of the following:

(in millions)	October 31, 2020
Term loan facility	\$ 1,018.8
Less: unamortized loan issuance costs (1)	17.7
Long-term debt, net of issuance costs	\$ 1,001.1

(1) In addition to the \$17.7 million of unamortized issuance costs related to the term loan facility, \$5.3 million of unamortized issuance costs related to our revolving credit facility are included within other assets on the October 31, 2020 condensed consolidated balance sheet.

In connection with the closing of the Acquisition, on August 30, 2019, the Company entered into a credit facility (the "Credit Agreement") that provided for:

- (i) a five-year senior secured term loan A facility (the "Term Loan Facility"), in an aggregate principal amount of \$1.25 billion, the proceeds of which were used to finance the Acquisition, to refinance substantially all outstanding indebtedness of HealthEquity and WageWorks and to pay related fees and expenses; and
- (ii) a five-year senior secured revolving credit facility (the "Revolving Credit Facility" and, together with the Term Loan Facility, the "Credit Facilities"), in an aggregate principal amount of up to \$350.0 million, which may be used for working capital and general corporate purposes, including acquisitions and other investments. No amounts were drawn under the Revolving Credit Facility as of October 31, 2020.

Borrowings under the Credit Facilities bear interest at an annual rate equal to, at the option of HealthEquity, either (i) LIBOR (adjusted for reserves) plus a margin ranging from 1.25% to 2.25% or (ii) an alternate base rate plus a margin ranging from 0.25% to 1.25%, with the applicable margin determined by reference to a leverage-based pricing grid set forth in the Credit Agreement. As of October 31, 2020, the stated interest rate was 1.65% and the effective interest rate was 2.18%. The Company is also required to pay certain fees to the lenders, including, among others, a quarterly commitment fee on the average unused amount of the Revolving Credit Facility at a rate ranging from 0.20% to 0.40%, with the applicable rate also determined by reference to a leverage-based pricing grid set forth in the Credit Agreement.

The loans made under the Term Loan Facility are required to be repaid as described in the following table:

Fiscal year ending January 31, (in millions)	Principal payments
Remaining 2021	\$ 15.6
2022	62.5
2023	70.3
2024	101.6
2025 (1)	768.8
Total principal payments	\$ 1,018.8

(1) The amount required to be repaid in 2025 reflects the \$200.0 million prepayment made in July 2020 with proceeds from the follow-on offering.

The Credit Agreement contains customary affirmative and negative covenants, including covenants that limit, among other things, the ability of the Company to incur additional indebtedness, create liens, merge or dissolve,

make investments, dispose of assets, engage in sale and leaseback transactions, make distributions and dividends and prepayments of junior indebtedness, engage in transactions with affiliates, enter into restrictive agreements, amend documentation governing junior indebtedness, modify its fiscal year and modify its organizational documents, in each case, subject to customary exceptions, thresholds, qualifications and "baskets." In addition, the Credit Agreement contains financial performance covenants, which require the Company to maintain (i) a maximum total net leverage ratio, measured as of the last day of each fiscal quarter, of no greater than 5.00 to 1.00, which steps down to 4.50 to 1.00 beginning with the fiscal quarter ending July 31, 2021 (subject to a customary "acquisition holiday" provision that allows the maximum total net leverage ratio to increase to 5.00 to 1.00 for the four fiscal quarter period ending on or following the date of a permitted acquisition by the Company in excess of \$100.0 million), and (ii) a minimum interest coverage ratio, measured as of the last day of each fiscal quarter, of no less than 3.00 to 1.00. The Company was in compliance with all covenants under the Credit Agreement as of October 31, 2020, and for the period then ended.

The obligations of HealthEquity under the Credit Agreement are required to be unconditionally guaranteed by WageWorks and each of the Company's subsequently acquired or organized direct and indirect domestic subsidiaries and are secured by security interests in substantially all assets of HealthEquity and the guarantors, in each case, subject to certain customary exceptions.

Note 9. Stock-based compensation

The following table shows a summary of stock-based compensation in the Company's condensed consolidated statements of operations and comprehensive income (loss) during the periods presented:

(in thousands)	Three months ended October 31,		Nine months ended October 31,	
	2020	2019	2020	2019
Cost of revenue	\$ 2,209	\$ 1,415	\$ 5,737	\$ 3,285
Sales and marketing	2,035	1,304	4,810	3,469
Technology and development	2,641	2,171	8,051	5,600
General and administrative	4,594	3,332	11,715	9,486
Merger Integration	—	1,220	—	1,220
Other expense, net	—	13,714	—	13,714
Total stock-based compensation expense	\$ 11,479	\$ 23,156	\$ 30,313	\$ 36,774

Stock award plans

Incentive Plan. The Company grants stock options, restricted stock units ("RSUs"), and restricted stock awards ("RSAs") under the HealthEquity, Inc. 2014 Equity Incentive Plan (as amended and restated, the "Incentive Plan"), which provided for the issuance of stock awards to the directors and team members of the Company to purchase up to an aggregate of 2.6 million shares of common stock.

In addition, under the Incentive Plan, the number of shares of common stock reserved for issuance under the Incentive Plan automatically increases on February 1 of each year, beginning as of February 1, 2015 and continuing through and including February 1, 2024, by 3% of the total number of shares of the Company's capital stock outstanding on January 31 of the preceding fiscal year, or a lesser number of shares determined by the board of directors. As of October 31, 2020, 6.4 million shares were available for grant under the Incentive Plan.

WageWorks Incentive Plan. At the closing of the Acquisition, and in accordance with the merger agreement related to the Acquisition, certain RSUs with respect to WageWorks common stock, granted under WageWorks, Inc. 2010 Equity Incentive Plan (the "WageWorks Incentive Plan"), were replaced by the Company and converted into RSUs with respect to 0.5 million shares of common stock of the Company. No additional shares were issued under the WageWorks Incentive Plan, and the period during which the remaining 5.3 million shares were available to be utilized expired on May 26, 2020.

Stock options

A summary of stock option activity is as follows:

(in thousands, except for exercise prices and term)	Number of options	Range of exercise prices	Outstanding stock options		
			Weighted-average exercise price	Weighted-average contractual term (in years)	Aggregate intrinsic value
Outstanding as of January 31, 2020	2,040	\$0.10 - 82.39	\$ 30.35	5.90	\$ 74,009
Granted	16	\$66.06	\$ 66.06		
Exercised	(183)	\$0.10 - 44.53	\$ 24.09		
Forfeited	(10)	\$25.45 - 44.53	\$ 38.02		
Outstanding as of October 31, 2020	1,863	\$1.25 - 82.39	\$ 31.23	5.10	\$ 42,046
Vested and expected to vest as of October 31, 2020	1,863		\$ 31.23	5.10	\$ 42,046
Exercisable as of October 31, 2020	1,584		\$ 26.55	4.70	\$ 41,025

Restricted stock units and restricted stock awards

A summary of RSU and RSA activity is as follows:

(in thousands, except weighted-average grant date fair value)	RSUs and PRSUs		RSAs and PRSAs	
	Shares	Weighted-average grant date fair value	Shares	Weighted-average grant date fair value
Outstanding as of January 31, 2020	1,380	\$ 63.33	235	\$ 61.91
Granted	1,220	56.57	14	74.81
Vested	(446)	54.78	(10)	62.80
Forfeited	(262)	66.77	(32)	62.41
Outstanding as of October 31, 2020	1,892	\$ 60.51	207	\$ 62.66

Performance restricted stock units and awards. In March 2018, the Company awarded 227,760 performance-based RSAs ("PRSAs"). The Company records stock-based compensation related to PRSAs when it is considered probable that the performance conditions will be met. The underlying shares were issued at 200% of the target level of achievement at the grant date. In March 2020, the Compensation Committee modified the awards by deeming the performance condition related to two-thirds of the awards to be achieved at 100% and creating a new performance condition related to the remaining one-third of the awards to reflect the state of the Company after the Acquisition of WageWorks. The new performance condition is based on the achievement of certain financial criteria measured on January 31, 2021. The modification affected 10 team members and did not result in an adjustment to stock-based compensation expense. The PRSAs cliff vest upon approval by the Compensation Committee. The modified performance condition for the one-third tranche allows for a range of vesting from 0% to 200% based on the level of achievement of the performance condition, and the Company believes it is probable that the PRSAs will vest at least in part. As the underlying shares were issued at grant date, they are subject to clawback based on actual Company performance.

In March 2019, the Company awarded 129,963 PRSUs. The Company records stock-based compensation related to PRSUs when it is considered probable that the performance conditions will be met. In March 2020, the Compensation Committee modified the awards by deeming the performance condition related to one-third of the awards to be achieved at 100% and creating new performance conditions related to the remaining two-thirds of the awards to reflect the state of the Company after the Acquisition of WageWorks. The new performance conditions are based on the achievement of certain financial criteria measured on January 31, 2021 and 2022. The modification affected 12 team members and resulted in incremental stock-based compensation expense of \$6.6 million, which will be recognized over the remaining service period, adjusted for the level of achievement of the performance conditions and any forfeitures. Prior to the modification, the Company did not believe the PRSUs were likely to vest, and as a result, \$2.9 million of previously recorded stock-based compensation expense was reversed during the three months ended April 30, 2020. The PRSUs cliff vest upon approval by the Compensation Committee. The modified performance conditions for the two-thirds tranche allow for a range of vesting from 0% to 200% based on the level of achievement of the new performance conditions, and the Company believes it is probable that the PRSUs will vest at least in part.

During the first and second quarters of fiscal 2021, the Company awarded 277,950 PRSUs subject to a market condition based on the Company's total shareholder return ("TSR") relative to the Russell 2000 index as measured on January 31, 2023. The Company used a Monte Carlo simulation to determine that the grant date fair value of the awards was approximately \$20.8 million. Compensation expense is recorded if the service condition is met regardless of whether the market condition is satisfied. The market condition allows for a range of vesting from 0% to 200% based on the level of performance achieved. The PRSUs cliff vest upon approval by the Compensation Committee.

Note 10. Fair value

Fair value measurements are made at a specific point in time, based on relevant market information. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Accounting standards specify a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1—quoted prices in active markets for identical assets or liabilities;
- Level 2—inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3—unobservable inputs based on the Company's own assumptions.

Level 1 instruments are valued based on publicly available daily net asset values. Level 1 instruments consist primarily of cash and cash equivalents. The carrying value of cash and cash equivalents approximate fair values as of October 31, 2020 due to the short-term nature of these instruments.

Our long-term debt is considered a Level 2 instrument and is recorded at book value in our condensed consolidated financial statements. Our long-term debt reprices frequently due to variable interest rate terms and entails no significant changes in credit risk. As a result, we believe the fair value of our long-term debt approximates carrying value.

Item 2. Management's discussion and analysis of financial condition and results of operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. The following discussion and analysis contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Statements that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "plan," "project," "seek," "should," "target," "will," "would" and similar expressions or variations intended to identify forward-looking statements. Such statements include, but are not limited to, statements concerning the impact of the ongoing COVID-19 pandemic on the Company, the anticipated synergies and other benefits of the acquisition of WageWorks, health savings accounts and other tax-advantaged consumer-directed benefits, tax and other regulatory changes, market opportunity, our future financial and operating results, our investment and acquisition strategy, our sales and marketing strategy, management's plans, beliefs and objectives for future operations, technology and development, economic and industry trends or trend analysis, expectations about seasonality, opportunity for portfolio purchases and other acquisitions, operating expenses, anticipated income tax rates, capital expenditures, cash flows and liquidity. These statements are based on the beliefs and assumptions of our management based on information currently available to us. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk factors" included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2020, this Quarterly Report on Form 10-Q, and our other reports filed with the SEC. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such events.

Overview

We are a leader and an innovator in providing technology-enabled services platforms that empower consumers to make healthcare saving and spending decisions. Consumers and employers use our platforms to manage tax-advantaged health savings accounts ("HSAs") and other consumer-directed benefits ("CDBs") offered by employers, including flexible spending accounts and health reimbursement arrangements ("FSAs" and "HRAs"), Consolidated Omnibus Budget Reconciliation Act ("COBRA") administration, commuter and other benefits, compare treatment options and pricing, evaluate and pay healthcare bills, receive personalized benefit information, access remote and telemedicine benefits, earn wellness incentives, and receive investment advice to grow their tax-advantaged healthcare savings.

The core of our offerings is the HSA, a financial account through which consumers spend and save long-term for healthcare expenses on a tax-advantaged basis. As of October 31, 2020, we administered 5.5 million HSAs, with balances totaling \$12.4 billion, which we call HSA Assets. Also, as of October 31, 2020, we administered 7.0 million complementary CDBs. We refer to the aggregate number of HSAs and other CDBs on our platforms as Total Accounts, of which we had 12.5 million as of October 31, 2020.

We reach consumers primarily through relationships with their employers, which we call Clients. We reach Clients primarily through a sales force that calls on Clients directly, relationships with benefits brokers and advisors, and integrated partnerships with a network of health plans, benefits administrators, benefits brokers and consultants, and retirement plan recordkeepers, which we call Network Partners.

We have grown our share of the growing HSA market from 4% in calendar year 2010 to 16% in 2020, including by 2% as a result of the acquisition (the "Acquisition") of WageWorks, Inc. ("WageWorks") on August 30, 2019. According to Devenir, today we are the largest HSA provider by accounts and second largest by assets. In addition, we believe we are the largest provider of other CDBs. We seek to differentiate ourselves through our proprietary technology, product breadth, ecosystem connectivity, and service-driven culture. Our proprietary technology is designed to help consumers optimize the value of their HSAs and other CDBs, as they gain confidence and skill in their management of financial responsibility for lifetime healthcare.

Our ability to engage consumers is enhanced by our platforms' capacity to securely share data in both directions with others in the health, benefits, and retirement ecosystems, which we call Ecosystem Partners. Our commuter benefits offering also leverages connectivity to an ecosystem of mass transit, ride hailing, and parking providers. These strengths reflect our "DEEP Purple" culture of remarkable service to customers and teammates, achieved by driving excellence, ethics, and process into everything we do.

We earn revenue primarily from three sources: service, custodial, and interchange. We earn service revenue mainly from fees paid by Clients on a recurring per-account per-month basis. We earn custodial revenue mainly from HSA Assets held at our members' direction in federally insured cash deposits, insurance contracts or mutual funds, and from investment of Client-held funds. We earn interchange revenue mainly from fees paid by merchants on payments that our members make using our physical payment cards and virtual platforms. See "Key components of our results of operations" for additional information on our sources of revenue, including regarding the adverse impacts caused by the ongoing COVID-19 pandemic.

Acquisition of WageWorks

On August 30, 2019, we completed the Acquisition of WageWorks and paid approximately \$2.0 billion in cash to WageWorks stockholders, financed through net borrowings of approximately \$1.22 billion under a new term loan facility and approximately \$816.9 million of cash on hand.

We expect the Acquisition to enable us to increase the number of our employer sales opportunities, the conversion of these opportunities to Clients, and the value of Clients in generating members, HSA Assets and complementary CDBs. WageWorks' historic strength of selling to employers directly and through health benefits brokers and advisors complements our distribution through health plans, benefit administrators and retirement record-keeping partners. With WageWorks' CDB capabilities, we are working to provide employers with a single partner for both HSAs and other CDBs, which is preferred by the vast majority of employers according to research conducted for us by Aite Group. For Clients that partner with us in this way, we believe we can produce more value by encouraging both CDB participants to contribute to HSAs and HSA-only members to take advantage of tax savings available through other CDBs. Accordingly, we believe that there are significant opportunities to expand the scope of services that we provide to our Clients.

The Acquisition has significantly increased the number of our Total Accounts, HSA Assets, Client-held funds, Adjusted EBITDA, total revenue, total cost of revenue, operating expenses, and other financial results. These increases impact the comparability of the period-over-period results described in this report.

Key factors affecting our performance

We believe that our future performance will be driven by a number of factors, including those identified below. Each of these factors presents both significant opportunities and significant risks to our future performance. See also "Results of Operations - Revenue" for information relating to the ongoing COVID-19 pandemic and also the section entitled "Risk factors" included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2020, this Quarterly Report on Form 10-Q and our other reports filed with the SEC.

WageWorks integration

On August 30, 2019, we completed the Acquisition of WageWorks. We are continuing our multi-year integration effort that we expect will produce long-term cost savings and revenue synergies. We have identified opportunities of approximately \$80 million in annualized ongoing net synergies to be achieved by the end of the fiscal year ending January 31, 2022, of which approximately \$55 million have been achieved as of October 31, 2020. Furthermore, we anticipate generating additional revenue synergies over the longer-term as our combined distribution channels and existing client base take advantage of the broader platform and service offerings and as we continue to drive member engagement. We estimate non-recurring costs to achieve these synergies of approximately \$100 million realized within 24 to 36 months of the closing of the Acquisition, resulting from investment in technology platforms, back-office systems and platform integration, as well as rationalization of cost of operations. As of October 31, 2020, we had incurred a total of approximately \$63 million of non-recurring merger integration costs related to the Acquisition.

Structural change in U.S. health insurance

We derive revenue primarily from healthcare-related saving and spending by consumers in the U.S., which are driven by changes in the broader healthcare industry, including the structure of health insurance. The average premium for employer-sponsored health insurance has risen by 22% since 2015 and 55% since 2010, resulting in increased participation in HSA-qualified health plans and HSAs and increased consumer cost-sharing in health

insurance more generally. We believe that continued growth in healthcare costs and related factors will spur continued growth in HSA-qualified health plans and HSAs and may encourage policy changes making HSAs or similar vehicles available to new populations such as individuals in Medicare. However, the timing and impact of these and other developments in U.S. healthcare are uncertain. Moreover, changes in healthcare policy, such as "Medicare for all" plans, could materially and adversely affect our business in ways that are difficult to predict.

Trends in U.S. tax law

Tax law has a profound impact on our business. Our offerings to members, Clients, and Network Partners consist primarily of services enabled, mandated, or advantaged by provisions of U.S. tax law and regulations. We believe that the present direction of U.S. tax policy is favorable to our business, as evidenced for example by recent regulatory action and bipartisan policy proposals to expand the availability of HSAs. However, changes in tax policy are speculative, and may affect our business in ways that are difficult to predict.

Our client base

Our business model is based on a B2B2C distribution strategy, meaning that we attract Clients and Network Partners to reach consumers to increase the number of our members with HSA accounts and complementary CDBs. We believe that there are significant opportunities to expand the scope of services that we provide to our current Clients.

Broad distribution footprint

We believe we have a diverse distribution footprint to attract new Clients and Network Partners. Our sales force calls on enterprise and regional employers in industries across the U.S., as well as potential Network Partners from among health plans, benefits administrators, and retirement plan record keepers.

Product breadth

We are the largest custodian and administrator of HSAs (by number of accounts), as well as a market-share leader in each of the major categories of complementary CDBs, including FSAs and HRAs, COBRA and commuter benefits administration. Our Clients and their benefits advisors increasingly seek HSA providers that can deliver an integrated offering of HSAs and complementary CDBs. With our CDB capabilities, we can provide employers with a single partner for both HSAs and complementary CDBs, which is preferred by the vast majority of employers, according to research conducted for us by Aite Group. We believe that the combination of HSA and complementary CDB offerings significantly strengthens our value proposition to employers, health benefits brokers and consultants, and Network Partners as a leading single-source provider.

Our proprietary technology platforms

We believe that innovations incorporated in our technology that enable consumers to make healthcare saving and spending decisions and maximize the value of their tax-advantaged benefits differentiate us from our competitors and drive our growth. We are building on these innovations by combining our HSA platform with WageWorks' complementary CDB offerings, giving us a full suite of CDB products, and adding to our solutions set and leadership position within the HSA sector. We intend to continue to invest in our technology development to enhance our platforms' capabilities and infrastructure, while maintaining a focus on data security and the privacy of our customers' data. For example, we are making significant investments in our platforms' architecture and related platform infrastructure to improve our transaction processing capabilities and support continued account and transaction growth, as well as in data-driven personalized engagement to help our members spend less, save more, and build wealth for retirement.

Our "DEEP Purple" service culture

The successful healthcare consumer needs education and guidance delivered by people as well as technology. We believe that our "DEEP Purple" culture, which we define as Driving Excellence, Ethics, and Process while providing remarkable service, is a significant factor in our ability to attract and retain customers and to address nimbly, opportunities in the rapidly changing healthcare sector. We make significant efforts to promote and foster DEEP Purple within our workforce. We invest in and intend to continue to invest in human capital through technology-enabled training, career development, and advancement opportunities.

Interest rates

As a non-bank custodian, we contract with federally insured banks, credit unions, and insurance company partners, which we collectively call our Depository Partners, to hold custodial cash assets on behalf of our members. We earn a material portion of our total revenue from interest paid to us by these partners. The lengths of our agreements with Depository Partners typically range from three to five years and may have fixed or variable interest

rate terms. The terms of new and renewing agreements may be impacted by the then-prevailing interest rate environment, which in turn is driven by macroeconomic factors and government policies over which we have no control. Such factors, and the response of our competitors to them, also determine the amount of interest retained by our members. We believe that diversification of Depository Partners, varied contract terms and other factors reduce our exposure to short-term fluctuations in prevailing interest rates and mitigate the short-term impact of sustained increases or declines in prevailing interest rates on our custodial revenue. Over longer periods, sustained shifts in prevailing interest rates affect the amount of custodial revenue we can realize on custodial assets and the interest retained by our members.

We expect our custodial revenue to continue to be adversely affected by the interest rate cuts by the Federal Reserve associated with the ongoing COVID-19 pandemic and other market conditions that have caused interest rates to decline significantly and, as a result, funds that we place with our Depository Partners in this environment will receive lower interest rates than we originally expected.

Interest on our long-term debt changes frequently due to variable interest rate terms, and as a result, our interest expense is expected to fluctuate based on changes in prevailing interest rates.

Our competition and industry

Our direct competitors are HSA custodians and other CDB providers. Many of these are state or federally chartered banks and other financial institutions for which we believe technology-based healthcare services are not a core business. Certain of our direct competitors have chosen to exit the market despite increased demand for these services. This has created, and we believe will continue to create, opportunities for us to leverage our technology platforms and capabilities to increase our market share. However, some of our direct competitors (including well-known mutual fund companies such as Fidelity Investments and healthcare service companies such as United Health Group's Optum) are in a position, should they choose, to devote more resources to the development, sale, and support of their products and services than we have at our disposal. In addition, numerous indirect competitors, including benefits administration technology and service providers, partner with banks and other HSA custodians to compete with us. Our Network Partners may also choose to offer competitive services directly, as some health plans have done. Our success depends on our ability to predict and react quickly to these and other industry and competitive dynamics.

As a result of the outbreak of the COVID-19 virus, we have seen an adverse impact on sales opportunities, with some opportunities delayed and most now being held virtually. As an increasing number of companies go out of business, the number of our Clients and potential Clients is adversely affected. Increased unemployment may mean that fewer of our members contribute to HSAs, FSAs or other CDBs. We have seen a significant decline in the use of commuter benefits due to many of our members working from home during the outbreak or other impacts from the outbreak, which has negatively impacted both our interchange revenue and service revenue, and this "work from home" trend may continue after the pandemic. We have also seen a decline in interchange revenue across all other products. The extent to which the COVID-19 virus will negatively impact our business is highly uncertain and cannot be accurately predicted.

Regulatory environment

Federal law and regulations, including the Affordable Care Act, the Internal Revenue Code, the Employee Retirement Income Security Act and Department of Labor regulations, and public health regulations that govern the provision of health insurance and provide the tax advantages associated with our products, play a pivotal role in determining our market opportunity. Privacy and data security-related laws such as the Health Insurance Portability and Accountability Act, or HIPAA, and the Gramm-Leach-Bliley Act, laws governing the provision of investment advice to consumers, such as the Investment Advisers Act of 1940, or the Advisers Act, the USA PATRIOT Act, anti-money laundering laws, and the Federal Deposit Insurance Act, all play a similar role in determining our competitive landscape. In addition, state-level regulations also have significant implications for our business in some cases. For example, our subsidiary HealthEquity Trust Company is regulated by the Wyoming Division of Banking, and several states are considering, or have already passed, new privacy regulations that can affect our business. Various states also have laws and regulations that impose additional restrictions on our collection, storage, and use of personally identifiable information. Privacy regulation in particular has become a priority issue in many states, including California, which in 2018 enacted the California Consumer Privacy Act broadly regulating California residents' personal information and providing California residents with various rights to access and control their data, and the new California Privacy Rights Act. We have also seen an increase in regulatory changes related to our products due to government responses to the COVID-19 pandemic and may continue to see additional regulatory changes. Our ability to predict and react quickly to relevant legal and regulatory trends and to correctly interpret their market and competitive implications is important to our success.

Our acquisition strategy

In addition to the WageWorks acquisition, we have a successful history of acquiring HSA portfolios from competitors who have chosen to exit the industry and complementary assets and businesses that strengthen our platform. We seek to continue this growth strategy and are regularly engaged in evaluating different opportunities. We have developed an internal capability to source, evaluate, and integrate acquired HSA portfolios. We intend to continue to thoughtfully pursue acquisitions of complementary assets and businesses that we believe will strengthen our platform.

Key financial and operating metrics

Our management regularly reviews a number of key operating and financial metrics to evaluate our business, determine the allocation of our resources, make decisions regarding corporate strategies and evaluate forward-looking projections and trends affecting our business. We discuss certain of these key financial metrics, including revenue, below in the section entitled "Key components of our results of operations." In addition, we utilize other key metrics as described below.

Total Accounts

The following table sets forth our HSAs, CDBs, and Total Accounts as of and for the periods indicated:

(in thousands, except percentages)	October 31, 2020	October 31, 2019	% Change	January 31, 2020
HSAs	5,460	5,031	9 %	5,344
New HSAs from Sales - Quarter-to-date	104	129	(19)%	379
New HSAs from Sales - Year-to-date	317	344	(8)%	724
New HSAs from Acquisitions - Year-to-date	—	757	(100)%	757
HSAs with investments	302	197	54 %	220
CDBs	7,060	7,504	(6)%	7,437
Total Accounts	12,520	12,535	0 %	12,781
Average Total Accounts - Quarter-to-date	12,084	9,970	21 %	12,603
Average Total Accounts - Year-to-date	12,429	6,482	92 %	8,013

The number of our HSAs and CDBs are key metrics because our revenue is driven by the amount we earn from them. The number of our HSAs increased by approximately 0.4 million, or 9%, from October 31, 2019 to October 31, 2020, due to further penetration into existing Network Partners and the addition of new Network Partners. The number of our CDBs decreased by approximately 0.4 million, or 6%, from October 31, 2019 to October 31, 2020, driven primarily by a decrease in commuter benefit accounts resulting from the impact of the COVID-19 pandemic and associated local governmental restrictions around the country.

HSAs are individually owned portable healthcare accounts. As HSA members transition between employers or health plans, they may no longer be enrolled in a high deductible health plan that qualifies them to continue to make contributions to their HSA.

HSA Assets

The following table sets forth our HSA Assets as of and for the periods indicated:

(in millions, except percentages)	October 31, 2020	October 31, 2019	% Change	January 31, 2020
HSA cash with yield (1)	\$ 8,759	\$ 7,564	16 %	\$ 8,301
HSA cash without yield (2)	258	381	(32)%	383
Total HSA cash	9,017	7,945	13 %	8,684
HSA investments with yield (1)	3,255	2,188	49 %	2,495
HSA investments without yield (2)	168	326	(48)%	362
Total HSA investments	3,423	2,514	36 %	2,857
Total HSA Assets	12,440	10,459	19 %	11,541
Average daily HSA cash with yield - Year-to-date	8,445	6,652	27 %	6,937
Average daily HSA cash with yield - Quarter-to-date	\$ 8,672	\$ 7,146	21 %	\$ 7,791

(1) HSA Assets that generate custodial revenue.

(2) HSA Assets that do not generate custodial revenue.

Our HSA Assets, which are our HSA members' assets for which we are the custodian or administrator, or from which we generate custodial revenue, consist of the following components: (i) cash deposits, which are deposits with our Depository Partners or other custodians, (ii) custodial cash deposits invested in annuity contracts with our insurance company partners, and (iii) investments in mutual funds through our custodial investment fund partners. We are continuing to transition HSA cash without yield to HSA cash with yield and expect to complete the transition in fiscal 2022. Measuring our HSA Assets is important because our custodial revenue is directly affected by average daily custodial balances for HSA Assets that are revenue generating.

Our total HSA Assets increased by \$2.0 billion, or 19%, from October 31, 2019 to October 31, 2020, due primarily to HSA contributions, decreased spending per HSA, and appreciation of invested balances.

Total HSA cash increased by \$1.1 billion, or 13%, from October 31, 2019 to October 31, 2020, due primarily to HSA contributions and decreased spending per HSA.

Our HSA investment assets increased by \$0.9 billion, or 36%, from October 31, 2019 to October 31, 2020, reflecting our strategy of helping our HSA members build wealth and invest for retirement.

Client-held funds

(in millions, except percentages)	October 31, 2020	October 31, 2019	% Change	January 31, 2020
Client-held funds (1)	\$ 798	\$ 670	19 %	\$ 779
Average daily Client-held funds - Year-to-date (1)	847	268	216 %	382
Average daily Client-held funds - Quarter-to-date (1)	819	500	64 %	727

(1) Client-held funds that generate custodial revenue.

Our Client-held funds are interest-earning deposits from which we generate custodial revenue. These deposits are amounts remitted by Clients and held by us on their behalf to pre-fund and facilitate administration of CDBs. We deposit the Client-held funds with our Depository Partners in interest-bearing, demand deposit accounts that have a floating interest rate and no set term or duration. Client-held funds fluctuate depending on the timing of funding and spending of CDB balances.

Adjusted EBITDA

We define Adjusted EBITDA, which is a non-GAAP financial metric, as adjusted earnings before interest, taxes, depreciation and amortization, amortization of acquired intangible assets, stock-based compensation expense, merger integration expenses, acquisition costs, gains and losses on marketable equity securities, and certain other non-operating items. We believe that Adjusted EBITDA provides useful information to investors and analysts in understanding and evaluating our operating results in the same manner as our management and our board of directors because it reflects operating profitability before consideration of non-operating expenses and non-cash expenses, and serves as a basis for comparison against other companies in our industry.

The following table presents a reconciliation of net income (loss), the most comparable GAAP financial measure, to Adjusted EBITDA for the periods indicated:

(in thousands)	Three months ended October 31,		Nine months ended October 31,	
	2020	2019	2020	2019
Net income (loss)	\$ 1,789	\$ (21,334)	\$ 3,467	\$ 39,854
Interest income	(174)	(2,046)	(850)	(5,273)
Interest expense	6,952	10,225	28,110	10,355
Income tax provision (benefit)	2,340	(9,918)	2,015	3,908
Depreciation and amortization	10,253	6,203	28,580	12,940
Amortization of acquired intangible assets	19,126	13,051	56,905	16,036
Stock-based compensation expense	11,479	8,222	30,313	21,840
Merger integration expenses (1)	8,193	17,675	31,328	20,459
Acquisition costs (2)	13	32,932	79	40,712
Gain on marketable equity securities	—	(285)	—	(27,570)
Other (3)	1,168	824	4,202	1,854
Adjusted EBITDA	\$ 61,139	\$ 55,549	\$ 184,149	\$ 135,115

- (1) For the three and nine months ended October 31, 2019, includes \$1.2 million of stock-based compensation expense from post-Acquisition merger integration activities.
- (2) For the three and nine months ended October 31, 2019, includes \$13.7 million of stock-based compensation expense from Acquisition-related cash and equity accelerations.
- (3) For the three months ended October 31, 2020 and 2019, Other consisted of amortization of incremental costs to obtain a contract of \$0.6 million and \$0.5 million, non-income-based taxes of \$0.4 million and \$0.2 million, and other costs of \$0.2 million and \$0.1 million, respectively. For the nine months ended October 31, 2020 and 2019, Other consisted of amortization of incremental costs to obtain a contract of \$1.4 million and \$1.4 million, non-income-based taxes of \$1.2 million and \$0.4 million, and other costs of \$1.5 million and \$0.1 million, respectively.

The following table further sets forth our Adjusted EBITDA as a percentage of revenue:

(in thousands, except percentages)	Three months ended October 31,				Nine months ended October 31,			
	2020	2019	\$ Change	% Change	2020	2019	\$ Change	% Change
Adjusted EBITDA	\$ 61,139	\$ 55,549	\$ 5,590	10 %	\$ 184,149	\$ 135,115	\$ 49,034	36 %
As a percentage of revenue	34 %	35 %			34 %	41 %		

Our Adjusted EBITDA increased by \$5.6 million, or 10%, from \$55.5 million for the three months ended October 31, 2019 to \$61.1 million for the three months ended October 31, 2020. The increase in Adjusted EBITDA was driven by the inclusion of WageWorks' results of operations for the full period of the current year, increased efficiency, and the overall growth of our business.

Our Adjusted EBITDA increased by \$49.0 million, or 36%, from \$135.1 million for the nine months ended October 31, 2019 to \$184.1 million for the nine months ended October 31, 2020. The increase in Adjusted EBITDA was driven by the inclusion of WageWorks' results of operations for the full period of the current year, increased efficiency, and the overall growth of our business.

Our use of Adjusted EBITDA has limitations as an analytical tool, and it should not be considered in isolation nor as a substitute for analysis of our results as reported under GAAP.

Key components of our results of operations

Acquisition of WageWorks

As the Acquisition closed on August 30, 2019, WageWorks' results of operations are included in our consolidated results of operations for the three and nine months ended October 31, 2020, but are only included in our consolidated results of operations for approximately two months out of each of the three and nine months ended October 31, 2019. In addition, the results of operations attributable to WageWorks may not be directly comparable to WageWorks' results of operations reported by WageWorks prior to the Acquisition.

Revenue

We generate revenue from three primary sources: service revenue, custodial revenue, and interchange revenue.

Service revenue. We earn service revenue from the fees we charge our Network Partners, Clients, and members for the administration services we provide in connection with the HSAs and other CDBs we offer. With respect to our Network Partners and Clients, our fees are generally based on a fixed tiered structure for the duration of the relevant service agreement and are paid to us on a monthly basis. We recognize revenue on a monthly basis as services are rendered to our members and Clients. As a result of the WageWorks Acquisition, service revenue now comprises a majority of our revenue.

Custodial revenue. We earn custodial revenue primarily from our HSA Assets deposited with our Depository Partners and with our insurance company partners, Client-held funds deposited with our Depository Partners, and recordkeeping fees we earn in respect of mutual funds in which our members invest. We deposit HSA cash with our Depository Partners pursuant to contracts that (i) typically have terms ranging from three to five years, (ii) provide for a fixed or variable interest rate payable on the average daily cash balances deposited with the relevant Depository Partner, and (iii) have minimum and maximum required deposit balances. We deposit the Client-held funds with our Depository Partners in interest-bearing, demand deposit accounts that have a floating interest rate and no set term or duration. We earn custodial revenue on HSA Assets and Client-held funds that is based on the interest rates offered to us by these Depository Partners. In addition, once a member's HSA cash balance reaches a certain threshold, the member is able to invest his or her HSA Assets in mutual funds through our custodial investment partner. We earn a recordkeeping fee, calculated as a percentage of custodial investments. We are continuing to transition HSA cash without yield to HSA cash with yield and expect to complete the transition in fiscal 2022.

Interchange revenue. We earn interchange revenue each time one of our members uses one of our physical payment cards or virtual platforms to make a purchase. This revenue is collected each time a member "swipes" our payment card to pay expenses. We recognize interchange revenue monthly based on reports received from third parties, namely, the card-issuing banks and card processors.

Cost of revenue

Cost of revenue includes costs related to servicing accounts, managing Client and Network Partner relationships and processing reimbursement claims. Expenditures include personnel-related costs, depreciation, amortization, stock-based compensation, common expense allocations (such as office rent, supplies, and other overhead expenses), new member and participant supplies, and other operating costs related to servicing our members. Other components of cost of revenue include interest retained by members on HSA cash and interchange costs incurred in connection with processing card transactions for our members.

Service costs. Service costs include the servicing costs described above. Additionally, for new accounts, we incur on-boarding costs associated with the new accounts, such as new member welcome kits, the cost associated with issuance of new payment cards, and costs of marketing materials that we produce for our Network Partners.

Custodial costs. Custodial costs are comprised of interest retained by our HSA members, in respect of HSA cash with yield, and fees we pay to banking consultants whom we use to help secure agreements with our Depository Partners. Interest retained by HSA members is calculated on a tiered basis. The interest rates retained by HSA members can change based on a formula or upon required notice.

Interchange costs. Interchange costs are comprised of costs we incur in connection with processing payment transactions initiated by our members. Due to the substantiation requirement on FSA/HRA-linked payment card transactions, payment card costs are higher for FSA/HRA card transactions. In addition to fixed per card fees, we are assessed additional transaction costs determined by the amount of the transaction.

Gross profit and gross margin

Our gross profit is our total revenue minus our total cost of revenue, and our gross margin is our gross profit expressed as a percentage of our total revenue. Our gross margin has been and will continue to be affected by a number of factors, including interest rates, the amount we charge our Network Partners, Clients, and members, the mix of our sources of revenue, how many services we deliver per account, and payment processing costs per account.

Operating expenses

Sales and marketing. Sales and marketing expenses consist primarily of personnel and related expenses for our sales and marketing staff, including sales commissions for our direct sales force, external agent/broker commission

expenses, marketing expenses, depreciation, amortization, stock-based compensation, and common expense allocations.

Technology and development. Technology and development expenses include personnel and related expenses for software development and delivery, information technology, data management, product, and security. Technology and development expenses also include software engineering services, the costs of operating our on-demand technology infrastructure, depreciation, amortization of capitalized software development costs, stock-based compensation, and common expense allocations.

General and administrative. General and administrative expenses include personnel and related expenses of, and professional fees incurred by our executive, finance, legal, internal audit, corporate development, compliance, and people departments. They also include depreciation, amortization, stock-based compensation, and common expense allocations.

Amortization of acquired intangible assets. Amortization of acquired intangible assets results primarily from intangible assets acquired in connection with business combinations. The assets include acquired customer relationships, acquired developed technology, and acquired trade names and trademarks, which we amortize over the assets' estimated useful lives, estimated to be 10-15 years, 2-5 years, and 3 years, respectively. We also acquired intangible HSA portfolios from third-party custodians. We amortize these assets over the assets' estimated useful life of 15 years. We evaluate our acquired intangible assets for impairment annually, or at a triggering event.

Merger integration. Merger integration expenses include personnel and related expenses, including severance, professional fees, legal expenses, and facilities- and technology-related expenses directly related to integration activities to merge operations as a result of the Acquisition.

Interest expense

Interest expense consists of accrued interest expense and amortization of deferred financing costs associated with our credit agreement. Interest on our long-term debt changes frequently due to variable interest rate terms, and as a result, our interest expense is expected to fluctuate based on changes in prevailing interest rates.

Other expense, net

Other expense, net, primarily consists of acquisition costs, gains and losses on marketable equity securities, and non-income-based taxes, less interest income earned on corporate cash.

Income tax provision

As of December 31, 2019, we were subject to federal and state income taxes in the United States based on a calendar tax year-end; however, beginning January 31, 2020, we began reporting federal and state income taxes using a January 31 year-end, consistent with the financial reporting fiscal year. We use the asset and liability method to account for income taxes, under which current tax liabilities and assets are recognized for the estimated taxes payable or refundable on the tax returns for the current fiscal year. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, net operating loss carryforwards, and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted statutory tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. Valuation allowances are established when necessary to reduce net deferred tax assets to the amount expected to be realized. As of October 31, 2020, we have recorded an overall net deferred tax liability with the exception of an insignificant amount of federal capital losses recorded as a net deferred tax asset on our condensed consolidated balance sheet.

Comparison of the three and nine months ended October 31, 2020 and 2019

Impact of Acquisition

The comparability of our operating results is impacted by our Acquisition of WageWorks on August 30, 2019. As the Acquisition closed on August 30, 2019, WageWorks' results of operations are included in our consolidated results of operations for the three and nine months ended October 31, 2020, but are only included in our consolidated results of operations for approximately two months out of each of the three and nine months ended October 31, 2019. Revenue and expense attributable to WageWorks generally is not separately identifiable due to the integration of WageWorks into our existing operations.

Revenue

The following table sets forth our revenue for the periods indicated:

(in thousands, except percentages)	Three months ended October 31,				Nine months ended October 31,			
	2020	2019	\$ Change	% Change	2020	2019	\$ Change	% Change
Service revenue	\$ 104,562	\$ 87,620	\$ 16,942	19 %	\$ 319,638	\$ 140,710	\$ 178,928	127 %
Custodial revenue	48,544	46,972	1,572	3 %	142,352	132,538	9,814	7 %
Interchange revenue	26,245	22,526	3,719	17 %	83,411	57,545	25,866	45 %
Total revenue	\$ 179,351	\$ 157,118	\$ 22,233	14 %	\$ 545,401	\$ 330,793	\$ 214,608	65 %

Service revenue. The \$16.9 million, or 19%, increase in service revenue from the three months ended October 31, 2019 to the three months ended October 31, 2020 was primarily due to the inclusion for the full period of service revenue associated with the CDBs added through the Acquisition in the current year, partially offset by the negative impact of the COVID-19 pandemic on service revenues related to commuter benefits and other CDBs.

The \$178.9 million, or 127%, increase in service revenue from the nine months ended October 31, 2019 to the nine months ended October 31, 2020 was primarily due to the inclusion for the full period of service revenue associated with the CDBs added through the Acquisition in the current year, partially offset by the negative impact of the COVID-19 pandemic on service revenues related to commuter benefits and other CDBs.

Custodial revenue. The \$1.6 million, or 3%, increase in custodial revenue from the three months ended October 31, 2019 to the three months ended October 31, 2020 was primarily due to the \$1.5 billion, or 21%, increase in the year-over-year average daily balance of HSA cash with yield. The increase was partially offset by a decrease in yield from 2.43% for the three months ended October 31, 2019 to 2.08% for the three months ended October 31, 2020, which was due in part to the interest rate cuts made by the Federal Reserve in response to the COVID-19 pandemic and due to the lower yield on HSA cash with yield added through the Acquisition.

The \$9.8 million, or 7%, increase in custodial revenue from the nine months ended October 31, 2019 to the nine months ended October 31, 2020 was primarily due to the \$1.8 billion, or 27%, increase in the year-over-year average daily balance of HSA cash with yield. The increase was partially offset by a decrease in yield from 2.50% for the nine months ended October 31, 2019 to 2.10% for the nine months ended October 31, 2020, which was due in part to the interest rate cuts made by the Federal Reserve in response to the COVID-19 pandemic and due to the lower yield on HSA cash with yield added through the Acquisition.

We are continuing to transition HSA cash without yield to HSA cash with yield and expect to complete the transition in fiscal 2022. This cash is being placed with our Depository Partners at prevailing interest rates, which we expect will generate additional custodial revenue.

Interchange revenue. The \$3.7 million, or 17%, increase in interchange revenue from the three months ended October 31, 2019 to the three months ended October 31, 2020 was primarily due to the inclusion for the full period of interchange revenue associated with the CDBs added through the Acquisition in the current year and an increased average interchange rate. The increase was partially offset by a decrease in spend per CDB, primarily with respect to FSA and commuter benefit accounts, as well as lower healthcare spending partially attributable to the restrictions imposed by local governments around the country in connection with the COVID-19 pandemic.

The \$25.9 million, or 45%, increase in interchange revenue from the nine months ended October 31, 2019 to the nine months ended October 31, 2020 was primarily due to the inclusion for the full period of interchange revenue associated with the CDBs added through the Acquisition in the current year and an increased average interchange rate. The increase was partially offset by a decrease in spend per CDB, primarily with respect to FSA and commuter benefit accounts, as well as lower healthcare spending partially attributable to the restrictions imposed by local governments around the country in connection with the COVID-19 pandemic.

Total revenue. Total revenue increased by \$22.2 million, or 14%, from the three months ended October 31, 2019 to the three months ended October 31, 2020, and by \$214.6 million, or 65% from the nine months ended October 31, 2019 to the nine months ended October 31, 2020, due to the inclusion for the full period of WageWorks' results of operations and related realized net revenue synergies in the current year.

Impact of COVID-19. Our business has been adversely affected by the recent outbreak of the COVID-19 virus, and we expect that it will continue to be adversely affected, including as a result of the associated interest rate cuts by the Federal Reserve and other market conditions that have caused interest rates to decline significantly. As a

result, funds that we place with our Depository Partners in this environment receive lower interest rates than we originally expected. Sales opportunities have also been impacted, with some opportunities delayed and most now being held virtually. In addition, we are required to support our Clients' open enrollment activities virtually. As an increasing number of companies go out of business, the number of our Clients and potential Clients is adversely affected. Increased unemployment may mean that fewer of our members contribute to HSAs, FSAs or other CDBs. We may be unable to meet our service level commitments to our Clients as a result of disruptions to our work force and disruptions to third party contracts that we rely on to provide our services. Our financial results related to certain of our products have also been adversely affected, such as commuter benefits, due to many of our members working from home during the outbreak and other impacts from the outbreak, and the "work from home" trend may continue after the pandemic. Clients may be unable to pay fees required under contracts and exercise "force majeure" or similar defenses, which would negatively impact our financial results. The extent to which the COVID-19 virus will continue to negatively impact our business remains highly uncertain and as a result may have a material adverse impact on our business and financial results.

Cost of revenue

The following table sets forth our cost of revenue for the periods indicated:

(in thousands, except percentages)	Three months ended October 31,				Nine months ended October 31,			
	2020	2019	\$ Change	% Change	2020	2019	\$ Change	% Change
Service costs	\$ 65,936	\$ 52,278	\$ 13,658	26 %	\$ 202,195	\$ 92,672	\$ 109,523	118 %
Custodial costs	4,762	4,384	378	9 %	14,805	12,716	2,089	16 %
Interchange costs	4,095	4,421	(326)	(7)%	13,985	13,177	808	6 %
Total cost of revenue	\$ 74,793	\$ 61,083	\$ 13,710	22 %	\$ 230,985	\$ 118,565	\$ 112,420	95 %

Service costs. The \$13.7 million, or 26%, increase in service costs from the three months ended October 31, 2019 to the three months ended October 31, 2020 was primarily due to the inclusion for the full period of WageWorks' results of operations in the current year and the resulting higher volume of accounts being serviced, including additional hiring of personnel to implement and support our new Network Partners and HSAs, increases in stock-based compensation expense, and increases in other expenses.

The \$109.5 million, or 118%, increase in service costs from the nine months ended October 31, 2019 to the nine months ended October 31, 2020 was primarily due to the inclusion for the full period of WageWorks' results of operations in the current year and the resulting higher volume of accounts being serviced, including additional hiring of personnel to implement and support our new Network Partners and HSAs, increases in stock-based compensation expense, and increases in other expenses.

Custodial costs. The \$0.4 million, or 9%, increase in custodial costs from the three months ended October 31, 2019 to the three months ended October 31, 2020 was due to an increase in the average daily balance of HSA cash with yield, which increased from \$7.1 billion for the three months ended October 31, 2019 to \$8.7 billion for the three months ended October 31, 2020. The increase was partially offset by a lower average interest rate paid on HSA cash with yield, which decreased from 0.21% for the three months ended October 31, 2019 to 0.18% for the three months ended October 31, 2020.

The \$2.1 million, or 16%, increase in custodial costs from the nine months ended October 31, 2019 to the nine months ended October 31, 2020 was due to an increase in the average daily balance of HSA cash with yield, which increased from \$6.7 billion for the nine months ended October 31, 2019 to \$8.4 billion for the nine months ended October 31, 2020. The increase was partially offset by a lower average interest rate paid on HSA cash with yield, which decreased from 0.22% for the nine months ended October 31, 2019 to 0.20% for the nine months ended October 31, 2020.

Interchange costs. The \$0.3 million, or 7%, decrease in interchange costs from the three months ended October 31, 2019 to the three months ended October 31, 2020 was due to a decrease in card spend per account as a result of the local government restrictions in response to the COVID-19 pandemic, partially offset by an overall increase in average Total Accounts, which increased primarily due to the inclusion for the full period of accounts added through the Acquisition of WageWorks in the current year.

The \$0.8 million, or 6%, increase in interchange costs from the nine months ended October 31, 2019 to the nine months ended October 31, 2020 was due to an overall increase in average Total Accounts, which increased primarily due to the inclusion for the full period of accounts added through the Acquisition of WageWorks in the

current year, partially offset by a decrease in card spend per account as a result of the local government restrictions in response to the COVID-19 pandemic.

Total cost of revenue. As we continue to add Total Accounts, we expect that our cost of revenue will increase in dollar amount to support our Network Partners, Clients, and members. Cost of revenue will continue to be affected by a number of different factors, including our ability to scale our service delivery, Network Partner implementation, account management functions, and the impact of the COVID-19 pandemic.

Operating expenses

The following table sets forth our operating expenses for the periods indicated:

(in thousands, except percentages)	Three months ended October 31,				Nine months ended October 31,			
	2020	2019	\$ Change	% Change	2020	2019	\$ Change	% Change
Sales and marketing	\$ 12,880	\$ 12,654	\$ 226	2 %	\$ 36,502	\$ 30,015	\$ 6,487	22 %
Technology and development	30,758	23,511	7,247	31 %	92,490	46,061	46,429	101 %
General and administrative	22,099	19,222	2,877	15 %	61,590	37,193	24,397	66 %
Amortization of acquired intangible assets	19,126	13,051	6,075	47 %	56,905	16,036	40,869	255 %
Merger integration	8,193	17,675	(9,482)	(54)%	31,328	20,459	10,869	53 %
Total operating expenses	\$ 93,056	\$ 86,113	\$ 6,943	8 %	\$ 278,815	\$ 149,764	\$ 129,051	86 %

Sales and marketing. The \$0.2 million, or 2%, increase in sales and marketing expense from the three months ended October 31, 2019 to the three months ended October 31, 2020 was primarily due to the inclusion for the full period of WageWorks' results of operations in the current year, which resulted in increased staffing, increases in other expenses, and higher stock-based compensation expense, partially offset by increased efficiencies.

The \$6.5 million, or 22%, increase in sales and marketing expense from the nine months ended October 31, 2019 to the nine months ended October 31, 2020 was primarily due to the inclusion for the full period of WageWorks' results of operations in the current year, which resulted in increased staffing, increases in other expenses, and higher stock-based compensation expense, partially offset by increased efficiencies.

We expect our sales and marketing expenses to increase for the foreseeable future as we continue to increase the size of our sales and marketing organization and expand into new markets. On an annual basis, we expect our sales and marketing expenses to remain relatively steady as a percentage of our total revenue. However, our sales and marketing expenses may fluctuate as a percentage of our total revenue from period to period due to the seasonality of our total revenue and the timing and extent of our sales and marketing expenses.

Technology and development. The \$7.2 million, or 31%, increase in technology and development expense from the three months ended October 31, 2019 to the three months ended October 31, 2020 was primarily due to the inclusion for the full period of WageWorks' results of operations in the current year, which resulted in increased personnel-related expense, increases in professional fees, increased stock-based compensation expense, increases in amortization and depreciation, and other increases, which were partially offset by increases in capitalized development and operating efficiencies.

The \$46.4 million, or 101%, increase in technology and development expense from the nine months ended October 31, 2019 to the nine months ended October 31, 2020 was primarily due to the inclusion for the full period of WageWorks' results of operations in the current year, which resulted in increased personnel-related expense, increases in professional fees, increased stock-based compensation expense, increases in amortization and depreciation, and other increases, which were partially offset by increases in capitalized development and operating efficiencies.

We expect our technology and development expenses to increase for the foreseeable future as we continue to invest in the development and security of our proprietary platforms. On an annual basis, we expect our technology and development expenses to increase as a percentage of our total revenue pursuant to our growth initiatives. Our technology and development expenses may fluctuate as a percentage of our total revenue from period to period due to the seasonality of our total revenue and the timing and extent of our technology and development expenses.

General and administrative. The \$2.9 million, or 15%, increase in general and administrative expense from the three months ended October 31, 2019 to the three months ended October 31, 2020 was primarily due to the inclusion for the full period of WageWorks' results of operations in the current year, which resulted in increased

personnel-related expense, increases in professional fees, and increased stock-based compensation expense, partially offset by increased efficiencies.

The \$24.4 million, or 66%, increase in general and administrative expense from the nine months ended October 31, 2019 to the nine months ended October 31, 2020 was primarily due to the inclusion for the full period of WageWorks' results of operations in the current year, which resulted in increased personnel-related expense, increases in professional fees, and increased stock-based compensation expense, partially offset by increased efficiencies.

We expect our general and administrative expenses to increase for the foreseeable future due to the additional demands on our legal, compliance, accounting, and insurance functions that we incur as we continue to grow our business, as well as other costs associated with being a public company. On an annual basis, we expect our general and administrative expenses to remain relatively steady as a percentage of our total revenue over the near term pursuant to our growth initiatives. Our general and administrative expenses may fluctuate as a percentage of our total revenue from period to period due to the seasonality of our total revenue and the timing and extent of our general and administrative expenses.

Amortization of acquired intangible assets. The \$6.1 million increase in amortization of acquired intangible assets from the three months ended October 31, 2019 to the three months ended October 31, 2020 was due to the inclusion for the full period of amortization related to identified intangible assets acquired through the Acquisition of WageWorks in the current year.

The \$40.9 million increase in amortization of acquired intangible assets from the nine months ended October 31, 2019 to the nine months ended October 31, 2020 was due to the inclusion for the full period of amortization related to identified intangible assets acquired through the Acquisition of WageWorks in the current year.

Merger integration. The \$8.2 million and \$31.3 million in merger integration expense for the three and nine months ended October 31, 2020, respectively, was due to personnel and related expenses, including expenses incurred in conjunction with the migration of accounts, severance, professional fees, technology-related, and facilities expenses directly related to the Acquisition of WageWorks. We expect integration expenses totaling approximately \$100 million in the aggregate to continue for 24 to 36 months following the closing of the Acquisition, which closed on August 30, 2019. As of October 31, 2020, we had incurred a total of approximately \$63 million of non-recurring merger integration costs related to the Acquisition of WageWorks.

Interest expense

The \$7.0 million and \$28.1 million in interest expense for the three and nine months ended October 31, 2020 consists primarily of interest accrued under our term loan facility and amortization of financing costs. We expect interest expense to decrease as a result of the principal repayments under our term loan facility.

Other expense, net

The \$30.5 million decrease in other expense, net, from \$30.9 million during the three months ended October 31, 2019 to \$0.4 million during the three months ended October 31, 2020 was primarily due to a \$32.9 million decrease in acquisition costs. The remainder of the change was due to a decrease in interest income of \$1.9 million, an increase in other expense of \$0.2 million, and a \$0.3 million non-recurring gain in connection with our equity investment in WageWorks during the three months ended October 31, 2019.

The \$6.3 million decrease in other expense, net, from \$8.3 million during the nine months ended October 31, 2019 to \$2.0 million during the nine months ended October 31, 2020 was primarily due to a \$40.6 million decrease in acquisition costs and a \$27.6 million non-recurring gain in connection with our equity investment in WageWorks during the three months ended October 31, 2019. The remainder of the change was due to a decrease in interest income of \$4.4 million and an increase in other expense of \$2.3 million.

Income tax provision (benefit)

Income tax expense for the three and nine months ended October 31, 2020 was \$2.3 million and \$2.0 million, respectively, as compared to income tax benefit of \$9.9 million and income tax expense of \$3.9 million for the three and nine months ended October 31, 2019, respectively. The tax provision for the three months ended October 31, 2020 increased \$12.2 million compared to the three months ended October 31, 2019. The tax provision for the nine months ended October 31, 2020 decreased \$1.9 million compared to the nine months ended October 31, 2019. The change was primarily due to a significant decrease in pre-tax book income coupled with a decrease in excess tax benefits on stock-based compensation expense and return-to-provision adjustments, which were partially offset by state apportionment changes recognized in the provision for income taxes.

Our effective income tax provision rate for the three and nine months ended October 31, 2020 was 56.7% and 36.8%, respectively, compared to an income tax benefit rate of 31.7% and income tax provision rate of 8.9% for the three and nine months ended October 31, 2019, respectively. The 88.4 and 27.9 percentage point increase for the three and nine months ended October 31, 2020, respectively, compared to the three and nine months ended October 31, 2019 was primarily due to the impact of excess tax benefits on stock-based compensation expense and return-to-provision adjustments, which were partially offset by state apportionment changes recognized in the provision for income taxes relative to pre-tax book income.

Seasonality

Seasonal concentration of our growth combined with our recurring revenue model create seasonal variation in our results of operations. Revenue results are seasonally impacted due to ancillary service fees, timing of HSA contributions, and timing of card spend. Cost of Revenue is seasonally impacted as a significant number of new and existing Network Partners bring us new HSAs and CDBs beginning in January of each year concurrent with the start of many employers' benefit plan years. Before we realize any revenue from these new accounts, we incur costs related to implementing and supporting our new Network Partners and new accounts. These costs of services relate to activating accounts and hiring additional staff, including seasonal help to support our member support center. These expenses begin to ramp up during our third fiscal quarter, with the majority of expenses incurred in our fourth fiscal quarter.

Liquidity and capital resources

Cash and cash equivalents overview

Our principal source of liquidity is our current cash and cash equivalents balances, collections from our service, custodial, and interchange revenue activities, and availability under our revolving credit facility described below. We rely on cash provided by operating activities to meet our short-term liquidity requirements, which primarily relate to the payment of corporate payroll and other operating costs, payments under our term loan facility, and capital expenditures.

As of October 31, 2020 and January 31, 2020, cash and cash equivalents were \$299.4 million and \$191.7 million, respectively. Cash and cash equivalents as of October 31, 2020 included approximately \$286.8 million of net proceeds we received from our follow-on public offering in July 2020 from the sale of 5,290,000 shares of our common stock, less the \$200.0 million we used to prepay long-term debt.

Capital resources

We have a "shelf" registration statement on Form S-3 on file with the SEC. This shelf registration statement, which includes a base prospectus, allows us at any time to offer any combination of securities described in the prospectus in one or more offerings. Unless otherwise specified in a prospectus supplement accompanying the base prospectus, we would use the net proceeds from the sale of any securities offered pursuant to the shelf registration statement for general corporate purposes, including, but not limited to, working capital, sales and marketing activities, general and administrative matters and capital expenditures, and if opportunities arise, for the acquisition of, or investment in, assets, technologies, solutions or businesses that complement our business. Pending such uses, we may invest the net proceeds in interest-bearing securities. In addition, we may conduct concurrent or other financings at any time.

In July 2020, we closed a follow-on public offering of 5,290,000 shares of common stock at a public offering price of \$56.00 per share, less the underwriters' discount. We received net proceeds of approximately \$286.8 million after deducting underwriting discounts and commissions of approximately \$8.9 million and other offering expenses of approximately \$0.6 million.

Our credit agreement includes a five-year senior secured revolving credit facility in an aggregate principal amount of up to \$350.0 million, which may be used for working capital and general corporate purposes, including the financing of acquisitions and other investments. For a description of the terms of the credit agreement, refer to Note 8—Indebtedness. We were in compliance with all covenants under the credit agreement as of October 31, 2020, and for the period then ended.

Use of cash

We used a portion of the net proceeds from the follow-on public offering to prepay \$200.0 million under our term loan facility, with the remaining proceeds to be used for general corporate purposes, which may include additional prepayments under our term loan facility or potential acquisitions.

Capital expenditures for the nine months ended October 31, 2020 and 2019 were \$48.6 million and \$22.4 million, respectively. We expect to continue our current level of increased capital expenditures for the remainder of the fiscal year ending January 31, 2021 as we continue to devote a significant amount of our capital expenditures to improving the architecture and functionality of our proprietary systems. Costs to improve the architecture of our proprietary systems include computer hardware, personnel and related costs for software engineering and outsourced software engineering services.

We believe our existing cash, cash equivalents, and revolving credit facility will be sufficient to meet our operating and capital expenditure requirements for at least the next 12 months. To the extent these current and anticipated future sources of liquidity are insufficient to fund our future business activities and requirements, we may need to raise additional funds through public or private equity or debt financing. In the event that additional financing is required, we may not be able to raise it on favorable terms, if at all.

The following table shows our cash flows from operating activities, investing activities, and financing activities for the stated periods:

(in thousands)	Nine months ended October 31,	
	2020	2019
Net cash provided by operating activities	\$ 120,717	\$ 74,070
Net cash used in investing activities	(76,730)	(1,715,393)
Net cash provided by financing activities	63,643	1,454,405
Decrease in cash and cash equivalents	107,630	(186,918)
Beginning cash and cash equivalents	191,726	361,475
Ending cash and cash equivalents	\$ 299,356	\$ 174,557

Cash flows from operating activities. Net cash provided by operating activities during the nine months ended October 31, 2020 resulted from net income of \$3.5 million, plus depreciation and amortization expense of \$85.5 million, stock-based compensation expense of \$30.3 million, and amortization of debt issuance costs of \$3.8 million, partially offset by other non-cash items and working capital changes totaling \$2.4 million.

Net cash provided by operating activities during the nine months ended October 31, 2019 resulted from net income of \$39.9 million, plus stock-based compensation expense of \$31.2 million, depreciation and amortization expense of \$28.8 million, amortization of debt issuance costs of \$1.1 million, and other non-cash items and working capital changes totaling \$0.7 million, partially offset by gains on marketable equity securities of \$27.6 million.

Cash flows from investing activities. Cash used in investing activities for the nine months ended October 31, 2020 resulted from \$37.2 million in software and capitalized software development, \$28.1 million in acquisitions of intangible member assets, and \$11.4 million in purchases of property and equipment.

Cash used in investing activities during the nine months ended October 31, 2019 was primarily the result of the Acquisition of WageWorks for \$1.63 billion, net of cash acquired, and purchases of marketable equity securities of \$53.8 million. In addition, we invested \$17.2 million in software and capitalized software development, \$5.2 million in purchases of property and equipment, and \$9.1 million in acquisitions of intangible member assets.

Cash flows from financing activities. Net cash provided by financing activities during the nine months ended October 31, 2020 resulted from \$286.8 million of net proceeds from our July 2020 follow-on public offering of 5,290,000 shares of common stock and the exercise of stock options of \$4.5 million. These items were partially offset by \$223.4 million of principal payments on our long-term debt and \$4.2 million used in the settlement of Client-held funds obligation.

Net cash provided by financing activities during the nine months ended October 31, 2019 resulted from net borrowings of \$1.22 billion under our term loan facility, net proceeds of \$458.5 million from the sale of 7,762,500 shares of our common stock in our July 2019 follow-on offering, and the exercise of stock options of \$7.3 million. These items were partially offset by \$230.9 million of cash used to settle Client-held funds obligations.

Contractual obligations

Except for the \$200.0 million prepayment under our term loan facility in July 2020, there were no material changes during the nine months ended October 31, 2020, outside of the ordinary course of business, in our contractual obligations from those disclosed in our Annual Report on Form 10-K for the fiscal year ended January 31, 2020.

Off-balance sheet arrangements

As of October 31, 2020, other than outstanding letters of credit issued under our revolving credit facility, we did not have any off-balance sheet arrangements. The majority of the standby letters of credit expire within one year. However, in the ordinary course of business, we will continue to renew or modify the terms of the letters of credit to support business requirements. The letters of credit are contingent liabilities, supported by our revolving credit facility, and are not reflected on our condensed consolidated balance sheets.

Critical accounting policies and significant management estimates

Our management's discussion and analysis of financial condition and results of operations are based upon our unaudited condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis, we evaluate our critical accounting policies and estimates. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable in the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions and conditions.

Our significant accounting policies are more fully described in Note 1 of the accompanying unaudited condensed consolidated financial statements and in Note 1 to our audited consolidated financial statements contained in our Annual Report on Form 10-K for the fiscal year ended January 31, 2020. There have been no significant or material changes in our critical accounting policies during the nine months ended October 31, 2020, as compared to those disclosed in "Management's discussion and analysis of financial condition and results of operations – Critical accounting policies and significant management estimates" in our Annual Report on Form 10-K for the fiscal year ended January 31, 2020.

Recent accounting pronouncements

See Note 1. Summary of business and significant accounting policies within the interim financial statements included in this Form 10-Q for further discussion.

Item 3. Qualitative and quantitative disclosures about market risk

Market risk

Concentration of market risk. We derive a substantial portion of our revenue from providing services to tax-advantaged healthcare account holders. A significant downturn in this market or changes in state and/or federal laws impacting the preferential tax treatment of healthcare accounts such as HSAs could have a material adverse effect on our results of operations. During the nine months ended October 31, 2020 and 2019, no one customer accounted for greater than 10% of our total revenue. We monitor market and regulatory changes regularly and make adjustments to our business if necessary.

Inflation. Inflationary factors may adversely affect our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of expenses as a percentage of revenue if our revenue does not correspondingly increase with inflation.

Concentration of credit risk

Financial instruments, which potentially subject us to concentrations of credit risk, consist primarily of cash and cash equivalents. We maintain our cash and cash equivalents in bank and other depository accounts, which frequently may exceed federally insured limits. Our cash and cash equivalents as of October 31, 2020 were \$299.4 million, of which \$2.3 million was covered by federal depository insurance. We have not experienced any material losses in such accounts and believe we are not exposed to any significant credit risk with respect to our cash and cash equivalents. Our accounts receivable balance as of October 31, 2020 was \$64.3 million. We have not experienced any significant write-offs to our accounts receivable and believe that we are not exposed to significant credit risk with respect to our accounts receivable; however, the extent to which the ongoing COVID-19 pandemic will negatively impact our credit risk is highly uncertain and cannot be accurately predicted. We continue to monitor our credit risk and place our cash and cash equivalents with reputable financial institutions.

Interest rate risk

HSA Assets and Client-held funds. Our HSA Assets consists of custodial HSA funds we hold in custody on behalf of our members. As of October 31, 2020, we had HSA Assets of approximately \$12.4 billion. As a non-bank custodian, we contract with our Depository Partners and insurance company partners to hold custodial cash assets on behalf of our members, and we earn a significant portion of our total revenue from interest paid to us by these partners. The contract terms typically range from three to five years and have either fixed or variable interest rates. As our HSA Assets increase and existing contracts expire, we seek to enter into new contracts with Depository Partners, the terms of which are impacted by the then-prevailing interest rate environment. The diversification of deposits among Depository Partners and varied contract terms substantially reduces our exposure to short-term fluctuations in prevailing interest rates and mitigates the short-term impact of a sustained increase or decline in prevailing interest rates on our custodial revenue. A sustained decline in prevailing interest rates may negatively affect our business by reducing the size of the interest rate yield, or yield, available to us and thus the amount of the custodial revenue we can realize. Conversely, a sustained increase in prevailing interest rates can increase our yield. An increase in our yield would increase our custodial revenue as a percentage of total revenue. In addition, if our yield increases, we expect the spread to also increase between the interest offered to us by our Depository Partners and the interest retained by our members, thus increasing our profitability. However, we may be required to increase the interest retained by our members in a rising prevailing interest rate environment. Changes in prevailing interest rates are driven by macroeconomic trends and government policies over which we have no control, such as the interest rate cuts by the Federal Reserve associated with the ongoing COVID-19 pandemic.

Our Client-held funds are interest earning deposits from which we generate custodial revenue. As of October 31, 2020, we had Client-held funds of approximately \$798.0 million. These deposits are amounts remitted by Clients and held by us on their behalf to pre-fund and facilitate administration of our other CDBs. These deposits are held with Depository Partners. We deposit the Client-held funds with our Depository Partners in interest-bearing, demand deposit accounts that have a floating interest rate and no set term or duration. A sustained decline in prevailing interest rates may negatively affect our business by reducing the size of the yield available to us and thus the amount of the custodial revenue we can realize from Client-held funds. Changes in prevailing interest rates are driven by macroeconomic trends and government policies over which we have no control.

Cash and cash equivalents. We consider all highly liquid investments purchased with an original maturity of three months or less to be unrestricted cash equivalents. Our unrestricted cash and cash equivalents are held in institutions in the U.S. and include deposits in a money market account that is unrestricted as to withdrawal or use. As of October 31, 2020, we had unrestricted cash and cash equivalents of \$299.4 million. Due to the short-term nature of these instruments, we believe that we do not have any material exposure to changes in the fair value of our cash and cash equivalents as a result of changes in interest rates.

Credit agreement. As of October 31, 2020, we had \$1.02 billion outstanding under our term loan facility and no amounts drawn under our revolving credit facility. Our overall interest rate sensitivity under these credit facilities is primarily influenced by any amounts borrowed and the prevailing interest rates on these instruments. The interest rate on our term loan credit facility and revolving credit facility is variable and was 1.65 percent at October 31, 2020. Accordingly, we may incur additional expense if interest rates increase in future periods. For example, a one percent increase in the interest rate on the amount outstanding under our credit facilities at October 31, 2020 would result in approximately \$10.1 million of additional interest expense over the next 12 months.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of October 31, 2020, the end of the period covered by this Quarterly Report on Form 10-Q. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to provide reasonable assurance that the information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that the information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide

only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of October 31, 2020, due to material weaknesses in internal control over financial reporting at its wholly owned subsidiary, WageWorks, which the Company acquired on August 30, 2019, the Company's disclosure controls and procedures were not effective. In accordance with interpretive guidance issued by SEC staff, the Company excluded WageWorks from its assessment of disclosure controls and procedures and internal control over financial reporting during the first year after completion of the acquisition. As of October 31, 2020, the WageWorks subsidiary is included in the above assessment regarding the effectiveness of the Company's disclosure controls and procedures.

Notwithstanding the ineffective disclosure controls and procedures as a result of the identified material weaknesses in its WageWorks subsidiary, management has concluded that the consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q present fairly, in all material respects, the Company's financial position, results of operations and cash flows in accordance with generally accepted accounting principles in the United States of America.

Material Weaknesses in Internal Control over Financial Reporting

Management identified certain deficiencies in WageWorks' internal control over financial reporting that aggregated to material weaknesses in the following components of the *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO Framework"):

Risk Assessment - WageWorks did not sufficiently identify and analyze risks arising from changes in the business environment, including risks arising in connection with the integration of acquisitions and financial system implementations.

Information and Communication – WageWorks did not establish cross-functional procedures and policies relating to effective information and communication necessary to support the functioning of internal control over financial reporting.

Monitoring – WageWorks did not implement effective monitoring controls that were responsive to changes in the business or the timely remediation of identified control deficiencies.

The COSO Framework component material weaknesses described above contributed to deficiencies at the control activity level that aggregated to the material weaknesses described below:

A. Accounting Close and Financial Reporting

The WageWorks subsidiary had inadequate process level and monitoring controls in the area of accounting close and financial reporting specifically, but not exclusively, around the review of account reconciliations, completeness and accuracy of data material to financial reporting, accounting estimates and related cut-off, the establishment, review, and implementation of accounting policies, and the review of the accuracy and completeness of certain manual and complex data feeds into journal entries and reconciliations of high-volume standard transactions.

B. Contract to Cash Process

The WageWorks subsidiary did not have effective controls around the contract-to-cash life cycle of service fees, including ineffective process level controls around billing set-up during customer implementation, managing change to existing customer billing terms and conditions, timely termination of customers, implementing complex and/or non-standard billing arrangements that require manual intervention or manual controls for billing to customers, processing timely adjustments, lack of robust, established and documented policies to assess collectability and reserve for revenue, bad debts and accounts receivable, availability of customer contracts, and reviews of non-standard contracts.

C. Review of New, Unusual or Significant Transactions

The WageWorks subsidiary did not have adequate controls over the review of the accounting for new, significant or unusual transactions.

D. Information Technology General Controls

The WageWorks subsidiary did not have effective controls related to information technology general controls (ITGCs) in the areas of logical access and change-management over certain information technology systems that supported its financial reporting processes. WageWorks' business process controls (automated and manual) that are dependent on the affected ITGCs were also deemed ineffective because they could have been adversely impacted.

These material weaknesses resulted in material misstatements of WageWorks' historical financial statements, which preceded the acquisition, and could result in a misstatement of our account balances or disclosures that would result in a material misstatement to the annual or interim condensed consolidated financial statements that would not be prevented or detected.

Integration and Remediation Efforts

Management has assessed the impact of the acquisition of WageWorks on its internal control over financial reporting and continues to assess changes driven by the integration of WageWorks with the existing operations at the consolidated Company. As part of this assessment, management has continued to evaluate its internal control environment to ensure that it has appropriate controls in place to mitigate the risks of a material misstatement to its consolidated financial statements associated with the WageWorks subsidiary and the Company as a whole.

In response to the material weaknesses in WageWorks' internal control over financial reporting, management has developed a plan to address the deficiencies associated with the disclosed material weaknesses, continues to utilize a third-party internal controls specialist, and has dedicated certain senior finance and accounting leadership team members to work on remediation efforts.

As previously disclosed, the WageWorks subsidiary had a material weakness related to an ineffective control environment, which was driven by the tone at the top of WageWorks. Due to the tone at the top, there was inadequate or ineffective senior accounting leadership, an insufficient complement of qualified resources with an appropriate level of knowledge, experience and training important to the Company's financial reporting requirements, and inadequate mechanisms and oversight to ensure accountability for the performance of internal control over financial reporting responsibilities. This material weakness has now been remediated. The following steps were executed by the Company to remediate the ineffective control environment driven by the tone at the top:

- replacement of WageWorks Audit Committee, Board of Directors, senior managers and executives, and organizational realignment;
- incorporation of WageWorks into the Company's training programs, led by the CEO and reinforced by executives throughout the combined Company, on the Company's Code of Business Conduct and Ethics, which included raising awareness and understanding of the importance of financial reporting integrity;
- incorporation of WageWorks control environment into the oversight of the Company's Internal Audit function and management's certification of internal controls,
- realignment of the WageWorks annual employee performance process to include consideration of employees' demonstration of the Company's values, including accountability for performance of internal controls; and
- incorporation of WageWorks into the Company's process to attract, develop, and retain a sufficient complement of qualified resources with appropriate and relevant competencies.

Additionally, in partial response to the other material weaknesses discussed above, management has incorporated certain WageWorks processes into the Company's existing entity-level and process-level controls, including, but not limited to, those that address the identification, review and assessment of new, unusual or significant transactions, those that address the monitoring of the accounting close cycle and the evaluation of accounting policies, and those that address certain ITGCs. Management is in the process of testing the operating effectiveness of these controls.

Changes in Internal Control Over Financial Reporting

Other than as described in the Integration and Remediation Efforts section above, there were no changes in the Company's internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the quarter ended October 31, 2020 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II—Other Information

Item 1. Legal Proceedings

From time-to-time, we may be subject to various legal proceedings and claims that arise in the normal course of our business activities. Our wholly owned subsidiary, WageWorks, is party to certain pending material litigation and other legal proceedings. Except for such matters, as of the date of this Quarterly Report on Form 10-Q, we were not a party to any litigation whereby the outcome of such litigation, if determined adversely to us, would individually or in the aggregate be reasonably expected to have a material adverse effect on our results of operations, cash flows or financial position. For a description of these legal proceedings, see Note 6—Commitments and contingencies of the Notes to condensed consolidated financial statements.

Item 1A. Risk factors

The risks described in “Risk factors” in our Annual Report on Form 10-K for the fiscal year ended January 31, 2020 could materially and adversely affect our business, financial condition and results of operations. Except as described below, there have been no material changes in such risks. These risk factors do not identify all risks that we face, and our operations could also be affected by factors that are not presently known to us or that we currently consider to be immaterial to our operations.

The ongoing COVID-19 pandemic has materially impacted our business and may continue to materially impact our business.

Our business has been, and may continue to be, materially and adversely affected by the current outbreak of the COVID-19 virus. The Federal Reserve’s interest rate cut in response to the economic impact of the COVID-19 pandemic and other interest rate market conditions have caused interest rates to decline significantly. As a result, the funds that we place with our depository partners in this environment have been, and are likely to continue to be for the foreseeable future, placed at lower interest rates than we originally expected. In addition, stock market volatility, such as a decline in the stock market, may decrease HSA investment assets and the related fees we earn from HSA investment assets. We have also seen an increase in regulatory changes related to our products due to government responses to the COVID-19 pandemic and may continue to see additional regulatory changes, which changes require substantial time and costs for us to ensure compliance. For example, regulatory changes related to our COBRA product have created uncertainty and additional workload on our team members, which could reduce our operational efficiency and result in additional costs.

Our financial results related to certain of our products have also been adversely affected. For example, we have seen a significant decline in the use of commuter benefits and our members' spend on healthcare, which has negatively impacted both our interchange revenue and service revenue. In addition, if the "work from home" trend continues after the pandemic, that would further negatively impact the revenue we receive from commuter benefits. We have also seen a decline in interchange revenue across all other products. Going forward, some Clients may be unable to pay fees required under contracts and exercise "force majeure" or similar defenses, which would negatively impact our financial results.

In addition, as an increasing number of companies go out of business, the number of our Clients and potential Clients could be adversely affected. Increased unemployment may mean that fewer of our members utilize HSAs or other CDBs. In the event our financial results continue to be severely impacted or the impact worsens, it may make it more difficult for us to comply with the financial covenants in our credit agreement, which could result in a breach of the financial covenants and the acceleration of our outstanding debt by our lenders.

As a result of the ongoing pandemic, substantially all of our team members are working from home. Sales opportunities have been impacted by the lack of travel and in-person meetings, with some opportunities delayed and most now being held virtually, and we will be supporting the open enrollment activities of our Clients virtually. We may be unable to meet our service level commitments to our Clients as a result of disruptions to our work force and disruptions to third-party contractors that we rely on to provide our services. Our team members may be less efficient at home, and it may take additional time for us to pursue significant business initiatives. The risk of cybersecurity breaches and incidents, and the potential impact of these on our operations, is also higher while our team members log in to our network remotely.

The extent to which the COVID-19 pandemic will continue to negatively impact our business remains highly uncertain and, as a result, may continue to have a material and adverse impact on our business and financial results.

Our management has identified material weaknesses in our internal control over financial reporting that could adversely affect our ability to report our financial condition and results of operations in a timely and accurate manner.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act. Our management has determined that our internal control over financial reporting was not effective due to the existence of material weaknesses arising out of our acquisition of WageWorks. See Item 4 - Controls and Procedures. Until fully remediated, these material weaknesses may materially adversely affect our ability to report our financial condition and results of operations in a timely and accurate manner. Although we have developed a plan to address the material weaknesses, we cannot provide a timeframe as to when the remediation will be completed and tested, nor can we assure you that the remediation, integration and testing process will not reveal additional material weaknesses or other deficiencies, so that our internal control over financial reporting and related disclosure controls and procedures are effective. If we are unable to report our results in a timely and accurate manner, we may not be able to comply with the applicable covenants in our credit agreement, and may be required to seek waivers or repay amounts under the credit agreement earlier than anticipated, which could adversely impact our liquidity and financial condition. Although we continually review and evaluate internal control systems to allow management to report on the sufficiency of our internal controls over financial reporting, we cannot assure you that we will not discover additional weaknesses in our internal control over financial reporting.

Item 6. Exhibits

Exhibit no.	Description	Form	File No.	Incorporate by reference	
				Exhibit	Filing Date
31.1+	Certification of the Principal Executive Officer Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
31.2+	Certification of the Principal Financial Officer Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
32.1*#	Certification of the Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				
32.2*#	Certification of the Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				
101.INS	XBRL Instance document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.				
101.SCH	Inline XBRL Taxonomy schema linkbase document				
101.CAL	Inline XBRL Taxonomy calculation linkbase document				
101.DEF	Inline XBRL Taxonomy definition linkbase document				
101.LAB	Inline XBRL Taxonomy labels linkbase document				
101.PRE	Inline XBRL Taxonomy presentation linkbase document				
104	The cover page from the Company's Quarterly Report on Form 10-Q for the quarter ended October 31, 2020, formatted in Inline XBRL.				

+ Filed herewith.

* Furnished herewith.

These certifications are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference in any filing the registrant makes under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, irrespective of any general incorporation language in any filings.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: December 9, 2020

HEALTH EQUITY, INC.

By: /s/ Darcy Mott
Name: Darcy Mott
Title: Executive Vice President and Chief Financial Officer

**Certification of Principal Financial Officer
pursuant to
Exchange Act Rules 13a-14(a) and 15d-14(a),
as adopted pursuant to
Section 302 of Sarbanes-Oxley Act of 2002**

I, Darcy Mott, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of HealthEquity, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 9, 2020

By: /s/ Darcy Mott

Name: Darcy Mott
Title: Executive Vice President and Chief Financial Officer
 (Principal Financial Officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, I, Jon Kessler, the Chief Executive Officer (Principal Executive Officer) of HealthEquity, Inc. (the "Company"), hereby certify that, to my knowledge:

1. Our Quarterly Report on Form 10-Q for the quarter ended October 31, 2020 (the "Report"), of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: December 9, 2020

By: /s/ Jon Kessler

Name: Jon Kessler
Title: *Chief Executive Officer*
(Principal Executive Officer)

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, I, Darcy Mott, Executive Vice President and Chief Financial Officer (Principal Financial Officer) of HealthEquity, Inc. (the "Company"), hereby certify that, to my knowledge:

1. Our Quarterly Report on Form 10-Q for the quarter ended October 31, 2020 (the "Report"), of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: December 9, 2020

By: /s/ Darcy Mott

Name: _____
Darcy Mott
Title: *Executive Vice President and Chief
Financial Officer
(Principal Financial Officer)*