

SYMBOL: **HSTM**  
 EXCHANGE: **NASDAQ**  
 RECENT PRICE: **\$3.25**



# Healthstream

**Rating Unchanged**

**BUY**

Vincent Colicchio, CFA (561) 994-5725  
 vcolicchio@noblefinancialgroup.com

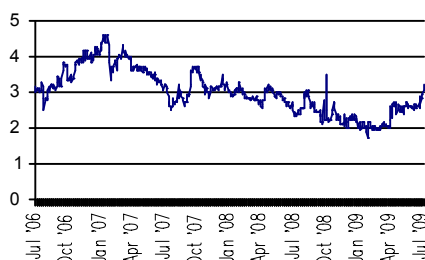
INDUSTRY SECTOR  
**Technology**

Wednesday, July 29, 2009

52 Week Low	\$1.58
52 Week High	\$3.09
Market Capitalization	\$69,500,000
Volume (Previous Trading Day)	113,749
Float	14,900,000
Basic Shares Outstanding	21,385,273
Institutional Holdings	25.6%
Short Interest	26,930
Average 90-day Vol.	11,339

## Noble Financial Headquarters

6501 Congress Avenue Suite 100  
 Boca Raton, FL 33487  
 Trading: 561.998.5489  
 Institutional Sales: 561.998.5491  
 www.nobleresearch.com



## Improved Research Margins Lift EPS Outlook

- Reported operating EPS of \$0.08, which exceeded our forecast and street consensus of \$0.04 on strong gross and operating margin overage
- Elevated gross margins, up 160 basis points year-over-year, should be sustainable due to improved business volume and efficiency gains within Research Division
- Increasing 2009 and 2010 operating EPS forecasts from \$0.18 and \$0.22 to \$0.19 and \$0.24, respectively on better Research Division margin outlook
- Raising 12-month price target from \$3.80 to \$4, which is based on 6.5x our 2010 adjusted-EBITDA forecast of \$12 million

### Fundamental Data

#### Revenue (millions)

PERIOD	F2008	F2009	F2010
1st Qtr	\$11.4A	\$13.6A	\$14.2E
2nd Qtr	\$13.0A	\$14.6A	\$15.5E
3rd Qtr	\$13.7A	\$14.7E	\$16.9E
4th Qtr	\$13.5A	\$14.7E	\$17.7E
	<b>\$51.6A</b>	<b>\$57.6E</b>	<b>\$64.3E</b>

#### Earnings (per share)

PERIOD	F2008	F2009	F2010
1st Qtr	\$0.00A	\$0.04A	\$0.05E
2nd Qtr	\$0.03A	\$0.08A	\$0.06E
3rd Qtr	\$0.03A	\$0.03E	\$0.07E
4th Qtr	\$0.07A	\$0.04E	\$0.07E
	<b>\$0.13A</b>	<b>\$0.19E</b>	<b>\$0.24E</b>

\*The EPS data reflects operating EPS.

Five-Year EPS Growth	25%
EV / EBITDA (ttm)	6.2x
Debt / Cap (mrq)	0%
Fiscal Year End	December
Div. / Div. Yield	N/A
Beta	0.78

HealthStream, Inc. (HealthStream) provides Internet-based solutions and services to meet the training, information and education needs of the healthcare industry. The company's learning products and services are used by healthcare organizations to meet a range of their training needs, including training and assessment.

ID: -1159060868

**Refer to pages HSTM/7 - HSTM/8 for Disclosures**

New York: 127 East 56th Street, New York NY 10022 212.497.4001 | Boston: One Boston Place Suite 1655, Boston, MA 02108 617.692.9340  
 St. Louis: 7949 Big Bend Boulevard, Webster Grove, MO 63119 314.687.1075

*Research margin  
improvements are sustainable*

## Investment Appraisal

HealthStream reported a solid quarter, which was highlighted by strong top line growth for both the HealthStream Learning (HL) and HealthStream Research (HR) divisions and a significant improvement in gross margins. HL Division revenue, comprising 64% of total revenue, grew 14% year-over-year on strong Internet-based subscription revenue, and HR Division revenue, comprising 36% of total revenue, grew 9% year-over-year on increased business volume. Gross margins increased year-over-year by 160 basis points due to a favorable mix shift from the HL and HR Divisions, strong revenue growth for the HR Division and efficiency gains within the HR Division.

While it is unclear if the margin benefits from mix shifts within the HL and HR Divisions will persist, we believe the strong revenue growth and efficiency gains (and associated margin improvement) within the HR Division are sustainable. Following three sequential quarters of strong (upper single-digit or higher) revenue growth from the HR Division, we are confident that solid growth will persist. With a large portion of product harmonization (from previous acquisitions) complete and the ramp of new salespeople gaining traction, the research business appears poised to maintain solid growth. While belated, the efficiency gains achieved in the HR Division by sharing and eliminating duplicate call center assets should be sustainable. While the company acquired the Jackson Organization in early 2007, it is still realizing benefits from harmonizing products and consolidating call center operations.

We are increasing our 2009 and 2010 operating EPS forecasts from \$0.18 and \$0.22 to \$0.19 and \$0.24, respectively, primarily due an improved outlook for Research Division gross margins. We are increasing our 12-month price target on HSTM stock from \$3.80 to \$4, as addressed in the next section.

*Raising price target from  
\$3.80 to \$4*

## Valuation Rationale

We are increasing our 12-month price target from \$3.80 to \$4, which is based on 6.5x our 2010 adjusted-EBITDA forecast of \$12 million. There are two factors that caused the increase to our price target; 1) we decided to use our 2010 EBITDA forecast rather than our 2009 EBITDA forecast as the basis of our valuation, since we are past the midpoint of 2009 and 2) we increased our 2010 adjusted-EBITDA forecast by 8%.

Our enterprise-value to adjusted-EBITDA based valuation is derived by multiplying a 6.5x multiple by our 2010 adjusted-EBITDA estimate for HealthStream of \$12 million, subtracting the company's net debt of (\$8.3 million) and then dividing the product by 21.6 million diluted shares. The 6.5x multiple used in our valuation represents a discount to the average enterprise-value to adjusted-EBITDA multiple (on 2010 estimates) of the company's peer group, which is 7.2x. The company's peer group includes Skilsoft (SKIL-NR) and Saba Software (SABA-NR). Adjusted EBITDA represents EBITDA plus share-based compensation expenses. We believe our valuation is conservative since HSTM has better growth prospects and similar risks to its peer group.

The key risk to HSTM stock is slower-than-expected adoption of online learning by the hospital industry, which has been slow to adopt new technology.

*EPS beats by \$0.04 on margin upside*

## Second Quarter EPS Exceeds Forecasts

HealthStream reported second quarter 2009 operating EPS of \$0.08, which exceeded our forecast and the street consensus of \$0.04. This result compares favorably to \$0.03 and \$0.04 in the year ago and sequential periods, respectively. The EPS result exceeded our forecast primarily due to a 200 basis point overage in gross margin and a 500 basis point negative variance in operating expenses as a percentage of revenue.

Total revenue increased 12% year-over-year from \$13 million in second quarter 2008 and 7% sequentially from \$13.6 million in first quarter 2009 to \$14.6 million in second quarter 2009. HealthStream Learning (HL) Division revenue, comprising 64% of total revenue, increased 14% year-over-year from \$8.2 million in second quarter 2008 and 9% sequentially from \$9.0 million in first quarter 2009 to \$9.3 million in second quarter 2009. The year-over-year increase was caused by an 18% increase in Internet-based subscription (IBS) revenue, consisting of HealthStream Learning Center (HLC) revenue (+15%), courseware subscription revenue and online training services revenue, and growth in professional services revenue, which was partly offset by a decline in revenue from live events, study guides and other project-based activities.

During the quarter, HLC revenue, which comprised 37% of total revenue, increased 15% year-over-year from \$4.7 million in second quarter 2008 and 6% sequentially from \$5.1 million in first quarter 2009 to \$5.4 million in second quarter 2009. Importantly, most key metrics for the HLC improved in the quarter: 1) net subscribers, under contract, increased 11% year-over-year and 3% sequentially, 2) net subscribers implemented increased 14% year-over-year and 5% sequentially, 3) subscriber renewal rates, based on number of users, increased year-over-year from 86% and sequentially from 101% to 104% and 4) subscriber renewal rates, based on contract value, increased year-over-year from 88% and sequentially from 98% to 102%.

HealthStream Research (HR) Division revenue, comprising 36% of total revenue, increased 9% year-over-year from \$4.8 million in second quarter 2008 and 13% sequentially from \$4.6 million in first quarter 2009 to \$5.3 million in second quarter 2009. HR division revenue, which consists of patient, physician, employee and community survey revenue, grew year-over-year due to increased business volume. During the quarter, the company added several new research clients and among existing research clients, 35 renewed contracts for multiple survey products and 57 added more research services.

Gross margin increased year-over-year from 62.6% in second quarter 2008 and sequentially from 61.3% in first quarter 2009 to 64.2% in second quarter 2009. The year-over-year improvement was caused by a favorable mix shift within HL and HR Division revenue, strong research sales and merger synergies within the HR Division. HL Division margin benefited from an increase of high-margin IBS and HLC revenue as a

portion of revenue. HR Division margin benefited from an increase of high-margin physician and employee survey revenue as a portion of revenue and merger synergies from the sharing and elimination of duplicate call center assets.

Operating margin increased year-over-year from 5.6% in second quarter 2008 and sequentially from 6.9% in first quarter 2009 to 12.8% in second quarter 2009. The year-over-year increase in operating margin was caused by higher gross margin and lower operating expenses as a portion of revenue.

### Balance Sheet & Cash Flow Update

As of the close of second quarter 2009, the company had a strong balance sheet, which consisted of cash and interest receivable of \$8.3 million and long-term debt and capital lease obligations of \$8,000.

During the quarter, the company cash from operations was \$1.7 million and free cash flow, defined as cash from operations less capital spending, was \$1.1 million. The company's days sales outstanding (DSOs) increased year-over-year from 48 in second quarter 2008, but declined sequentially from 69 in first quarter 2009 to 58 in the second quarter 2009.

*Raising EPS forecasts on favorable margin trends*

### Increasing 2009 & 2010 EPS Forecasts

We are increasing our 2009 and 2010 operating EPS forecasts from \$0.18 and \$0.22 to \$0.19 and \$0.24, respectively, primarily due to an increase in our gross margin forecasts. For 2009 and 2010, we increased our gross margin forecasts by 90 and 120 basis points, respectively. The increase in our gross margin forecasts was primarily caused by stronger HR Division margin trends. We have become more optimistic on the the outlook for HR Division margins due to improved revenue momentum and evidence of merger-related synergies.

Our key model assumptions include the following:

#### 2009 model

Revenue growth: 12%

Gross margin: 63%

Operating margin: 8%

Operating EPS growth: 45%

#### 2010 model

Revenue growth: 12%

Gross margin: 64%

Operating margin: 9%

Operating EPS growth: 27%

**Table 1**  
**HealthStream Inc.**  
**Quarterly and Annual Earnings Model**

\$ in thousands, except per share amounts

	1Q:07A	2Q:07A	3Q:07A	4Q:07A	2007A	1Q:08A	2Q:08A	3Q:08A	4Q:08A	2008A
HealthStream Learning (HL) revenue	6,479	6,505	6,849	7,675	27,507	7,539	8,198	8,470	8,642	32,849
% of revenue	80%	54%	58%	64%	63%	66%	63%	62%	64%	64%
HealthStream Research (HR) revenue	1,623	5,541	4,960	4,317	16,441	3,883	4,815	5,192	4,861	18,751
% of revenue	20%	46%	42%	36%	37%	34%	37%	38%	36%	36%
Total revenue	\$8,101	\$12,046	\$11,809	\$11,992	\$43,948	\$11,422	\$13,013	\$13,662	\$13,503	\$51,600
Cost of revenue	2,915	4,359	4,336	4,552	16,162	4,528	4,863	5,153	5,110	19,654
Gross profit	5,186	7,687	7,473	7,440	27,786	6,894	8,150	8,509	8,393	31,946
Margin %	64.0%	63.8%	63.3%	62.0%	63.2%	60.4%	62.6%	62.3%	62.2%	61.9%
Product development expenses	1,079	1,100	1,165	963	4,307	1,285	1,330	1,531	1,524	5,670
% of revenue	13.3%	9.1%	9.9%	8.0%	9.8%	11.3%	10.2%	11.2%	11.3%	11.0%
Sales and marketing expenses	1,734	2,821	2,294	2,364	9,213	2,552	2,694	3,122	2,452	10,820
% of revenue	21.4%	23.4%	19.4%	19.7%	21.0%	22.3%	20.7%	22.9%	18.2%	21.0%
Depreciation and amortization expenses	856	1,198	1,317	1,132	4,503	1,246	1,209	1,175	1,193	4,823
% of revenue	10.6%	9.9%	11.2%	9.4%	10.2%	10.9%	9.3%	8.6%	8.8%	9.3%
General and administrative expenses	1,608	2,160	1,967	2,113	7,848	1,767	2,193	2,090	2,102	8,152
% of revenue	19.8%	17.9%	16.7%	17.6%	17.9%	15.5%	16.9%	15.3%	15.6%	15.8%
Operating profit	-91	408	730	868	1,915	44	724	591	1,122	2,481
Margin %	-1.1%	3.4%	6.2%	7.2%	4.4%	0.4%	5.6%	4.3%	8.3%	4.8%
Adjusted EBITDA	912	1,947	2,140	2,161	7,160	1,443	2,206	1,944	2,483	8,076
Margin %	11.3%	16.2%	18.1%	18.0%	16.3%	12.6%	17.0%	14.2%	18.4%	15.7%
Other income, net	140	22	27	39	228	22	23	18	9	72
Pretax income	49	430	757	907	2,143	66	747	609	1,131	2,553
Taxes	4	5	18	-1,972	-1,945	-	8	-	-309	-301
Tax rate	8.1%	1.2%	2.4%	NM	-90.7%	0.0%	1.1%	0.0%	-27.3%	-11.8%
Net income	45	425	739	2,879	4,088	66	739	609	1,440	2,854
EPS - GAAP	\$0.00	\$0.02	\$0.03	\$0.13	\$0.18	\$0.00	\$0.03	\$0.03	\$0.07	\$0.13
EPS - operating basis	\$0.00	\$0.02	\$0.03	\$0.04	\$0.09	\$0.00	\$0.03	\$0.03	\$0.07	\$0.13
Shares - diluted	22,603	22,782	22,664	22,755	22,701	22,727	22,579	21,910	21,601	22,204
<b>Sequential percentage change</b>										
HealthStream Learning (HL) revenue	-1.7%	0.4%	5.3%	12.1%	NA	-1.8%	8.8%	3.3%	2.0%	NA
HealthStream Research (HR) revenue	-17.5%	241.5%	-10.5%	-13.0%	NA	-10.0%	24.0%	7.8%	-6.4%	NA
Total revenue	-5.3%	48.7%	-2.0%	1.5%	NA	-4.8%	13.9%	5.0%	-1.2%	NA
Operating EPS	-95.8%	NM	74.8%	16.1%	NA	-92.3%	1027.0%	-15.1%	139.8%	NA
<b>Year-to-year percentage change</b>										
HealthStream Learning (HL) revenue	3.8%	1.3%	17.5%	16.5%	9.7%	16.4%	26.0%	23.7%	12.6%	19.4%
HealthStream Research (HR) revenue	26.9%	207.8%	200.0%	119.3%	145.4%	139.3%	-13.1%	4.7%	12.6%	14.1%
Total revenue	7.7%	46.5%	57.9%	40.1%	38.3%	41.0%	8.0%	15.7%	12.6%	17.4%
Adjusted EBITDA	-32.0%	90.3%	75.4%	14.0%	30.7%	58.2%	13.3%	-9.2%	14.9%	12.8%
Operating EPS	-93.3%	45.0%	54.0%	-21.1%	-18.5%	44.8%	75.4%	-14.8%	76.0%	41.0%

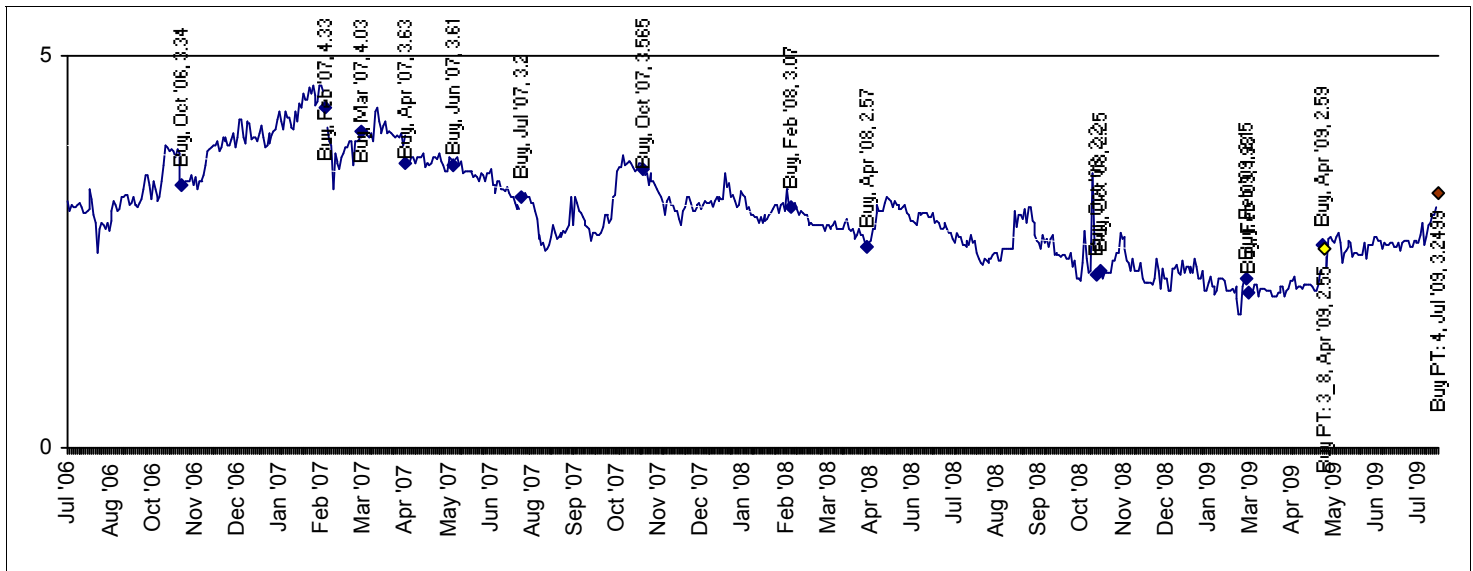
Source: Company reports and Noble Financial Group forecasts.

**Table 2**  
**HealthStream Inc.**  
**Quarterly and Annual Earnings Model**

\$ in thousands, except per share amounts

	1Q:09A	2Q:09A	3Q:09E	4Q:09E	2009E	1Q:10E	2Q:10E	3Q:10E	4Q:10E	2010E
HealthStream Learning (HL) revenue	8,989	9,334	9,427	9,540	37,290	9,445	10,134	10,945	11,875	42,400
% of revenue	66%	64%	64%	65%	65%	67%	65%	65%	67%	66%
HealthStream Research (HR) revenue	4,630	5,250	5,303	5,117	20,301	4,733	5,396	5,963	5,843	21,935
% of revenue	34%	36%	36%	35%	35%	33%	35%	35%	33%	34%
Total revenue	\$13,619	\$14,584	\$14,730	\$14,657	\$57,590	\$14,178	\$15,530	\$16,908	\$17,719	\$64,335
Cost of revenue	5,268	5,228	5,391	5,350	21,237	5,218	5,684	6,137	6,414	23,453
Gross profit	8,351	9,356	9,339	9,307	36,353	8,961	9,846	10,770	11,305	40,882
Margin %	61.3%	64.2%	63.4%	63.5%	63.1%	63.2%	63.4%	63.7%	63.8%	63.5%
Product development expenses	1,534	1,447	1,694	1,642	6,317	1,531	1,631	1,775	1,860	6,798
% of revenue	11.3%	9.9%	11.5%	11.2%	11.0%	10.8%	10.5%	10.5%	10.5%	10.6%
Sales and marketing expenses	2,714	2,602	3,167	3,137	11,620	2,921	3,153	3,382	3,508	12,963
% of revenue	19.9%	17.8%	21.5%	21.4%	20.2%	20.6%	20.3%	20.0%	19.8%	20.1%
Depreciation and amortization expenses	1,266	1,250	1,340	1,319	5,176	1,276	1,382	1,505	1,559	5,722
% of revenue	9.3%	8.6%	9.1%	9.0%	9.0%	9.0%	8.9%	8.9%	8.8%	8.9%
General and administrative expenses	1,901	2,195	2,416	2,389	8,901	2,169	2,361	2,553	2,676	9,758
% of revenue	14.0%	15.1%	16.4%	16.3%	15.5%	15.3%	15.2%	15.1%	15.1%	15.2%
Operating profit	936	1,862	722	821	4,341	1,063	1,320	1,556	1,701	5,640
Margin %	6.9%	12.8%	4.9%	5.6%	7.5%	7.5%	8.5%	9.2%	9.6%	8.8%
Adjusted EBITDA	2,348	3,263	2,213	2,291	10,115	2,490	2,853	3,211	3,411	11,966
Margin %	17.2%	22.4%	15.0%	15.6%	17.6%	17.6%	18.4%	19.0%	19.3%	18.6%
Other income, net	-1	-2	10	10	17	9	10	12	14	45
Pretax income	935	1,860	732	831	4,358	1,072	1,330	1,568	1,715	5,685
Taxes	57	132	51	58	298	75	93	110	120	398
Tax rate	6.1%	7.1%	7.0%	7.0%	6.8%	7.0%	7.0%	7.0%	7.0%	7.0%
Net income	878	1,728	681	773	4,059	997	1,237	1,458	1,595	5,287
EPS - GAAP	\$0.04	\$0.08	\$0.03	\$0.04	\$0.19	\$0.05	\$0.06	\$0.07	\$0.07	\$0.24
EPS - operating basis	\$0.04	\$0.08	\$0.03	\$0.04	\$0.19	\$0.05	\$0.06	\$0.07	\$0.07	\$0.24
Shares - diluted	21,567	21,626	21,776	22,026	21,749	22,126	22,226	22,376	22,626	22,339
<b>Sequential percentage change</b>										
HealthStream Learning (HL) revenue	4.0%	3.8%	1.0%	1.2%	NA	-1.0%	7.3%	8.0%	8.5%	NA
HealthStream Research (HR) revenue	-4.7%	13.4%	1.0%	-3.5%	NA	-7.5%	14.0%	10.5%	-2.0%	NA
Total revenue	0.9%	7.1%	1.0%	-0.5%	NA	-3.3%	9.5%	8.9%	4.8%	NA
Operating EPS	-38.9%	96.3%	-60.9%	12.2%	NA	28.5%	23.5%	17.1%	8.2%	NA
<b>Year-to-year percentage change</b>										
HealthStream Learning (HL) revenue	19.2%	13.9%	11.3%	10.4%	13.5%	5.1%	8.6%	16.1%	24.5%	13.7%
HealthStream Research (HR) revenue	19.2%	9.0%	2.1%	5.3%	8.3%	2.2%	2.8%	12.4%	14.2%	8.1%
Total revenue	19.2%	12.1%	7.8%	8.5%	11.6%	4.1%	6.5%	14.8%	20.9%	11.7%
Adjusted EBITDA	62.7%	47.9%	13.8%	-7.7%	25.2%	6.1%	-12.6%	45.1%	48.9%	18.3%
Operating EPS	1301.9%	144.1%	12.4%	-47.4%	45.2%	10.7%	-30.3%	108.5%	101.0%	26.8%

Source: Company reports and Noble Financial Group forecasts.



## DEFINITIONS OF RATINGS

Research provided by Noble Financial currently employs the following definitions when offering stock opinions. The percentages represent our current (issued in the last twelve months) allocation of investment ratings to investment banking clients and non-clients.

Noble Financial Rating:	Reports on (NASD Rule 2711(h)(1)(A):	Investment Banking Clients	Non-Client Reports
Buy	A total return is anticipated in excess of the Russell 2000 over the next 12 months. Total return expectations should be higher for stocks which possess greater risk.	4.7%	70.5%
Hold	Hold the shares, neither a materially positive total return nor a materially negative total return is anticipated at this time.	0	18.0%
Sell	The Stock should not be bought and you should sell if owned. The Stock is expected to under-perform.	0	11.5%

## DISCLAIMER

All statements or opinions contained herein that include the words "we", "us", or "our" are solely the responsibility of Noble Financial and do not necessarily reflect statements or opinions expressed by any person or party affiliated with the company mentioned in this report. Any opinions expressed herein are subject to change without notice. All information provided herein is based on public and non-public information believed to be accurate and reliable, but is not necessarily complete and cannot be guaranteed. No judgment is hereby expressed or should be implied as to the suitability of any security described herein for any specific investor or any specific investment portfolio. The decision to undertake any investment decision regarding the security mentioned herein should be made by each reader of this publication based on its own appraisal of the implications and risks of such decision.

This publication is intended for information purposes only and shall not constitute an offer to buy/sell or the solicitation of an offer to buy/sell any security mentioned in this report, nor shall there be any sale of the security herein in any state or domicile in which said offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such state or domicile. This publication and all information, comments, statements or opinion contained or expressed herein are applicable only as of the date of this publication subject to change without prior notice. Past performance is not indicative of future results

## IMPORTANT DISCLOSURE

Within the past 30 days, a Noble Financial Company Research employee and/or their immediate supervisors have not effected a transaction for their own account(s) in the investment(s) referred to in this report, nor will such a transaction take place within 5 days of its publication.

On the date of this report, a Noble Financial Company, and/or persons connected with it, and/or their respective directors, and/or representatives, and/or employees do not have a long or short position in the subject company of this report.

A Noble Financial Company intends to seek investment banking business with this company in the next three months.

A Noble Financial Company is a market maker in the subject company.





#### **WARNING**

This report is intended to provide general securities advice, and does not purport to make any recommendation that any securities transaction is appropriate for any recipient particular investment objectives, financial situation or particular needs. Prior to making any investment decision, recipients should assess, or seek advice from their advisers, on whether any relevant part of this report is appropriate to their individual circumstances. If a recipient was referred to a Noble Financial Company by an investment adviser, that adviser may receive a benefit in respect of transactions effected on the recipients behalf, details of which will be available on request in regard to a transaction that involves a personalized securities recommendation. Additional risks associated with the security mentioned in this report that might impede achievement of the target can be found in its initial report issued by Noble Financial Company. This report may not be reproduced, distributed or published for any purpose, unless authorized by The Noble Financial Company listed below.

#### **US CLIENTS**

For purposes of distribution in the United States this report is prepared for persons who can be defined as "Major Institutional Investors" under US regulations. Any US person receiving this report and wishing to effect a transaction in any security discussed herein, must do so through a US registered broker or dealer. Noble International Investments, Inc. is a US registered broker dealer.

#### **RESEARCH ANALYST CERTIFICATION**

All views expressed in this report accurately reflect my personal views about the subject company or issuers.

#### **RECEIPT OF COMPENSATION**

No part of my compensation was, is, or will be directly or indirectly related to any specific recommendations or views expressed in this report.

#### **OWNERSHIP AND MATERIAL CONFLICTS OF INTEREST**

Neither I nor anybody in my household has a financial interest in the securities of the subject company.

Additional information is available upon request. Any recipient of this report that wishes further information regarding the subject company or the disclosure information mentioned herein, should contact Noble Financial either by mail or phone.

Noble International Investments, Inc., dba, Noble Financial Capital Markets is a FINRA registered broker/dealer.