

HealthStream, Inc (NASDAQ: HSTM)

Industry: Healthcare Technology

Rating: Hold

Target: US \$25.41

Date: 12 30, 2014



Executive Summary

Business Summary

HealthStream is a healthcare software service provider that was founded in 1990. Targeting hospitals around the United States, HealthStream aims to provide online services that will satisfy the training, certification and development needs as well as offer research to streamline competency and performance management.

Business Drivers

HealthStream primarily works on a subscription based model, where customers are given the option to subscribe to their services as well as purchase extra courseware/tools.

HealthStream has done much to give its services credibility, such as establishing itself as a CAHPS certified vendor. HealthStream believes that the healthcare education market is extremely fragmented, and that their competitive advantage stems from their services are provided on a streamlined online database.

Valuation Summary

Although revenue growth (32%) in the past 9 months has exceeded expectations, both the comparable analysis and discounted cash flow analysis suggest that the company is overvalued. Despite this, we believe that the strengths of this company cannot be discredited.

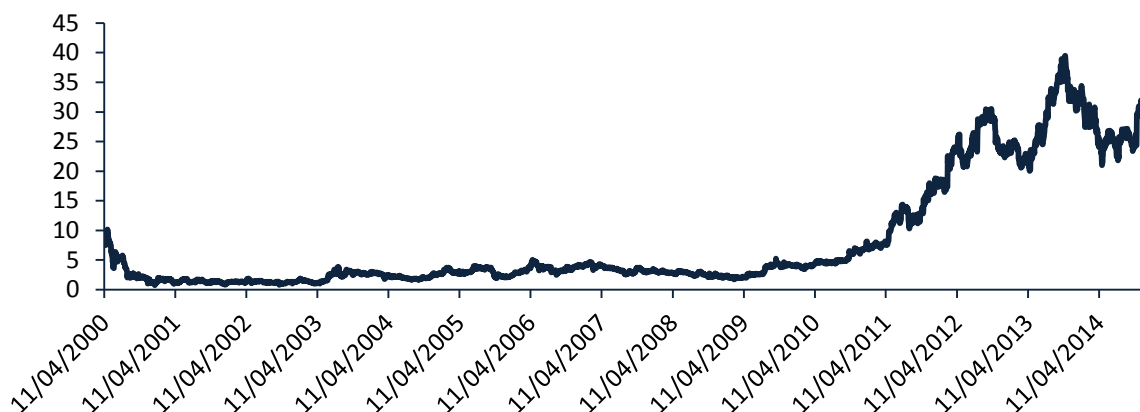
Key Statistics

	Current		2012	2013	Current
Price	\$29.46	Enterprise Value	\$644.38M	\$783.40M	\$697.69M
Date	12 28, 2014	Debt / Enterprise Value	0	0	0
52 Week Range	20.76-\$34.64	Debt / Equity	0	0	0
Shares Outstanding	27.63M	Price / Book Value	4.63	6.37	5.09
Market Capitalization	\$814.10M	Price / Earnings	81.1	103.4	88.2
Enterprise Value	\$697.69M	Cash	\$41.36M	\$59.54M	\$64.93M
Beta	1.83	ROA	4.6%	4.4%	4.2%

Balance Sheet (\$US, thousands)	2010	2011	2012	2013	LTM
Cash & Cash Equivalents	\$17,868	\$76,904	\$41,365	\$59,537	\$64,927
Current Assets (Excluding Cash)	\$26,403	\$34,175	\$76,926	\$87,587	\$98,008
Total Assets	\$82,011	\$154,237	\$174,528	\$212,594	\$243,333
Current Liabilities	\$24,746	\$32,448	\$35,032	\$56,212	\$74,437
Total Debt	\$0	\$0	\$0	\$0	\$0
Total Liabilities	25,220	\$33,322	\$42,332	\$63,161	\$82,091
Total Equity	\$56,791	\$120,915	\$132,196	\$149,433	\$161,242

Income Statement (\$US, thousands)	2010	2011	2012	2013	LTM
Revenue	\$65,754	\$82,066	\$103,732	\$132,274	\$162,400
EBITDA	\$11,940	\$16,757	\$20,105	\$22,482	\$25,810
Depreciation & Amortization	\$4,880	\$5,412	\$6,661	\$7,852	\$9,980
Interest benefit (expense)	(\$22)	\$3	\$133	\$212	\$2
Tax	(\$2,884)	(\$4,404)	(\$5,932)	(\$6,424)	(\$6,322)
Net Income	\$4,154	\$6,944	\$7,645	\$8,418	\$9,510

Historical Prices



Business Description

HealthStream Inc. was founded in 1990 and focuses on providing software as a service based workforce development solutions and research/patient experiences solutions for healthcare organizations in the United States. With a customer base of approximately 4,000 healthcare organizations throughout the United States, HealthStream's products and services are organized into two segments-HealthStream Workforce Development Solutions and HealthStream Research/Patient Experience Solutions.

HealthStream Workforce Development Solutions (78% of Revenues in 2013)

Working on a subscription basis model, HealthStream has over 3.71 million total subscribers as of December 2013, where each subscriber is denoted as an end user who utilizes at least one of HSTM's platforms. Within HealthStream's Workforce Development Solutions are three platforms: HLC (HealthStream Learning Center), HCC (HealthStream Competency Center) and HPC (HealthStream Performance Center). Pricing is determined based on the subscription itself, which includes things such as courseware provided, training, and implementation fees.

1. HLC focuses on delivering educational activities and training courseware. This includes training, assessment, and talent development.
2. HCC provides organizations with tools to assess the competency of management and appraise performance. These services help satisfy the mandatory requirement dictated by the Joint Commission to conduct assessments and report performance competencies.
3. HPC provides a platform for organizations to streamline their appraisal processes, with the goal of increasing completion rates and consistency within all aspects of the customers' performance management.

HealthStream Research/Patient Experience Solutions (22% of Revenues in 2013)

By providing customers with surveys, data analyses, and other research-based measurement tools this segment helps compliment the aforementioned Workforce Development Solutions. By providing a platform to help customers collect, analyze, and provide recommendations they can better enhance performance and develop future plans. Pricing for these services are based on factors such as the type of survey, delivery method, sample size, etc.

Industry Overview

In the United States, all of the 4.8 million hospital healthcare professionals are required by federal mandates to have training in various areas. Furthermore, a report done by the American Hospital Association in 2010 states that staffing issues and personnel shortages have indicated the need for training and education is crucial for the retention and recruitment incentive of both physicians and nurses alike.

All kinds of healthcare professionals utilize continuing education to keep-to-date with developments and licensing requirements. Professions such as nurses, emergency medical services personnel, first responder personnel, radiologic technicians and physicians fall under this category. Other than hospitals, other sub-segments of the health industry such as Pharmaceutical and medical device companies must also provide their staff with training mandated by the healthcare industry. This indicates that the demand for quality healthcare training will not falter any time soon.

Despite this, the healthcare education industry is fragmented, with many competitors providing different product and services. These include online products, live events, written material, and simulation-based training. Although in the past many professionals would look towards offline publications like journals and conferences, they are costly and inconvenient. By implementing a streamlined online service, HealthStream can effectively distribute quality and updated information and help healthcare organizations reduce their rising operating costs.

Secondly, many health organizations utilize research to increase knowledge regarding public perceptions, patients' experiences and assessing workforce competency. Interest has increased towards this research due to the CAHPS (Consumer Assessment of Healthcare Providers and systems) initiated by the partnership between CMS (Centers for Medicare and Medicaid Services) and AHRQ (Agency for Healthcare), which requires hospitals to submit data to CMS in order to receive the full reimbursement payment rates from CMS. As a CAHPS certified vendor HealthStream this adds credibility to the company's name.

Business Strengths

Strong Financial Position

HealthStream has no debt as of third quarter of 2014. Furthermore, HSTM's quick ratio is 1.97 which is higher than the industry average of 1.76. HealthStream is able to utilize its assets to cover any short term liquidity needs. Also, compared to the industry average, HealthStream's revenue growth as of the third quarter is 32% compared to the previous year, which suggests the company's ability to increase future income and improve earnings per share.

Stability of the Healthcare Industry

It is safe to say that the demand for healthcare will continue to increase as the population gets older. In translation, the demand for proper healthcare training and research will be valued higher. For companies such as HealthStream, this is a good sign for growth, which has been reflected in their constant increase in revenues since its inception.

Management

Robert Frist, Chairman of the Board, President, CEO

One of the company co-founders, and has served as chairman of the board and CEO since 1990. As the CEO since its inception, it is without a doubt that HealthStream would not be where it is today without the leadership of Robert Frist. Furthermore, as the top shareholder, Mr. Frist also owns 5.6 million shares or 21% of the shares outstanding, indicating his strong loyalty towards the success of the company.

Acquisitions

On March 3, 2014, HealthStream acquired all of Health Care Compliance Strategies (HCCS) for \$13 million in cash and 81,614 shares of common stock. HCCS was a provider of online training courses and learning management systems, and with this acquisition HSTM hoped to strengthen its courseware and training programs. HCCS revenues for the year ended Dec 31, 2013 was around \$6.8 million.

With the acquisition, Healthstream anticipated consolidated revenues in 2014 to grow by 25%-29% as compared to 2013. Furthermore they anticipated that the company's 2014 full-year operating income to decrease between 2%-11% compared to 2013 due to the combined impact of deferred revenue write downs and large transaction costs related to the acquisition of HCCS.

However, looking at the third quarter year-to date of 2014 compared to 2013, in the first nine months HealthStream's Revenue increased by 32%, and operating income increased by 9% when compared to the first nine months of 2013.

Valuation

Comparable Company Analysis

Comparable Analysis							
Company		Enterprise			Last 12 Months		
		Market Cap	Value	Sales	EV/Sales	EBITDA	EV/EBITDA
Cornerstone OnDemand	CSOD	1960.13	1956.52	242.05	8.08	-32	-61.14
Computer Programs and Systems, Inc	CPSI	688.90	660.21	209.75	3.15	59.96	11.01
National Research Corporation	NRCIB	416.15	386.23	96.64	4.00	31.74	12.17
Saba Software, Inc	SABA	254.67	240.49	122.32	1.97	-9	-26.72
Oracle Corporation	ORCL	204,442	183,969.90	38,499	4.78	17,587	10.46
Mean		41552.37	37442.67		4.39		-10.84
Median		688.9	660.21		4.00		10.46
HealthStream, Inc	HSTM	814.11	697.69	162.4	4.30	25.81	27.03

In our comparable analysis, I employed the use of EV/Sales and EV/EBITDA. EV/EBITDA was used because it allows us to value the company independently from any capital changes it made. The metric of EV/Sales was employed because these businesses below are driven by sales via transactions and subscription fees. Furthermore, many of the comparables below had negative EBITDA, which affected the outcome of EV/EBITDA.

In terms of EV/EBITDA, we can see that HealthStream is the highest among its peers, which suggests that the company may be overvalued. Regarding EV/Sales, it is somewhere near the average among the group, which tells us that the company is performing at the industry standard.

Valuation

Discounted Cash Flow

HealthStream
Discounted Cash Flow Analysis

(\$US in Thousands)

	Actual				Forecast				
	2011	2012	2013	2014	2015	2016	2017	2018	
Revenue	\$82,066.00	\$ 103,732.00	\$132,274.00	\$ 165,342.50	\$ 206,678.13	\$ 248,013.75	\$ 297,616.50	\$ 357,139.80	
% Growth		26%	28%	25%	25%	20%	20%	20%	
Operating Cost	\$38,539.00	\$ 50,268.00	\$ 67,362.00	\$ 82,671.25	\$ 103,339.06	\$ 124,006.88	\$ 148,808.25	\$ 178,569.90	
% Revenue	47%	48%	51%	50%	50%	50%	50%	50%	
EBIT	\$ 11,348.00	\$ 13,577.00	\$ 14,842.00	\$ 19,841.10	\$ 24,801.38	\$ 29,761.65	\$ 35,713.98	\$ 42,856.78	
% margin	14%	13%	11%	12%	12%	12%	12%	12%	
Taxes	\$ 4,404.00	\$ 5,932.00	\$ 6,424.00	\$ 7,936.44	\$ 9,920.55	\$ 11,904.66	\$ 14,285.59	\$ 17,142.71	
% Tax Rate	38.8%	43.7%	43.3%	40%	40%	40%	40%	40%	
EBIAT	\$ 6,944.00	\$ 7,645.00	\$ 8,418.00	\$ 11,904.66	\$ 14,880.83	\$ 17,856.99	\$ 21,428.39	\$ 25,714.07	
Plus: Depreciation	\$ 5,412.00	\$ 6,661.00	\$ 7,852.00	\$ 10,747.26	\$ 13,434.08	\$ 16,120.89	\$ 19,345.07	\$ 23,214.09	
% Revenue	7%	6%	6%	6.50%	6.50%	6.50%	6.50%	6.50%	
Less Capex	\$ 10,180.00	\$ 8,751.00	\$ 8,711.00	\$ 16,534.25	\$ 20,667.81	\$ 24,801.38	\$ 29,761.65	\$ 35,713.98	
% Revenue	12%	8%	7%	10%	10%	10%	10%	10%	
Change in WC	\$ 2,472.00	\$ 740.00	\$ 7,959.00	\$ 8,267.13	\$ 10,333.91	\$ 12,400.69	\$ 14,880.83	\$ 17,856.99	
% Revenue	3%	1%	6%	5%	5%	5%	5%	5%	
Free Cash Flow	\$ 4,648.00	\$ 6,295.00	\$ 15,518.00	\$ 14,384.80	\$ 17,981.00	\$ 21,577.20	\$ 25,892.64	\$ 31,071.16	
Discount Rate	7.7%								
Discount Period				1	2	3	4	5	
Discount Factor				0.93	0.86	0.80	0.74	0.69	
Present Free Cash Flow				\$ 13,359.45	\$ 15,508.98	\$ 17,284.20	\$ 19,262.61	\$ 21,467.48	

Revenue is projected to grow at healthy 25% in 2014 and 2015 given the 2014 third quarter results and historical growth. Afterwards, revenue is projected to grow at a modest 20% given the expectation that the company will continue to obtain more subscriptions while losing some revenue due to the entering of competitors.

Valuation

When calculating the WACC it is important to note that HealthStream has no debt, therefore the WACC is just the cost of equity. Because the company has had history (Since 2002) of having no debt, it is my assumption that the company will not plan to change its capital structure anytime soon.

The Enterprise value was used with the Gordon Growth model with a perpetuity growth rate of 4%.

Through this DCF analysis, HealthStream is worth \$25.41/share, which should be noted is less than its actual price. Again, the indication is that there is a chance that the company may be overvalued at its current price.

However, there are strengths to the company that cannot be ignored. This includes the revenue growth in 2014 that led to increased earnings, the fact that the company has no debt in their capital structure. This has led me to believe that potential investors should hold this stock.

WACC Calculation

Target Capital Structure	
Debt-to-Total Capitalization	0
Equity-to-Total Capitalization	100.0%

Cost of Equity	
Risk-free Rate	2.2%
Market Risk Premium	5.2%
Levered Beta	1.83

Cost of Equity	7.7%
WACC	7.7%

Terminal Value

PV Cash Flows	\$ 86,882.71
Perpetuity growth rate	4%
WACC	7.7%

Terminal Value	\$ 879,268.84
PV of Terminal Value	\$ 607,498.57

Enterprise Value	\$ 694,381.29
Debt	\$ -
Fair Value	\$ 694,381.29

Shares Outstanding	27,327
Stock Price	\$ 25.41
Current Price	\$ 29.46
Downside	14%

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