

October 29, 2009

HEALTH GRADES, INC.

Greater visibility of the Health Grades brand on-line was apparent in the September 2009 quarter as the Company reported strong sequential sales growth driven primarily by the Internet Business segment.

Price (10/28/09)

\$4.16

Exchange/Ticker

Nasdaq: HGRD

Update

Buy

(Unchanged)

Price Target

\$6.75

(Unchanged)

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Highlights:

- Upside Surprise.** Health Grades delivered \$13.3 million in revenue during the September 2009 quarter, providing \$0.07 in earnings per share. Results topped our and consensus estimates Surprise came from better than expected performance in the Internet Business Group responsible for the sale of the Company's quality reports on-line, internet advertising and sponsorship programs as well as the new *ConnectingPoint* product.
- Provider Services.** Health Grades' mainstay hospital marketing and quality-improvement business, contributed \$7.8 million to the top-line in the quarter. Sales increased 6% from the same quarter in the year-ago quarter.
- Updated Earnings Estimates.** Our 2009 estimates are now \$50.7 million in sales providing \$0.23 in earnings per share (from \$49.9 million and \$0.19).
- Guidance.** Our 2009 sales estimate is slightly below the Company new guidance for sales in the year. During the third quarter earnings conference call, CFO Alan Dodge indicated that the Company now expects sales in 2009 to come in at least 30% higher than 2008. This implies year 2009 sales of \$51.6 million.
- Rating and Price Target.** We reiterate our Buy rating for Health Grades. Despite the fact that our EPS estimates increased, we are maintaining our price target at \$6.75. Valuations remain hampered as economic conditions in the U.S. remain challenging for all sectors.

Commercial Services / HGRD: Nasdaq

DESCRIPTION
Health Grades, Inc. provides quality of service information to consumers, providers and payers of health care services. Over 5,000 hospitals, 620,000 physicians and 16,000 nursing homes across the U.S. are rated along a proprietary system following key medical issues. The Company's headquarters are located in Golden, Colorado. Web site at WWW.HEALTHGRADES.COM is used as for advertising and delivering its data products.

INVESTMENT OUTLOOK
In our view , Health Grades has made a timely entrance into the health services industry with its rating service. Increased interest and support for consumer directed health care creates demand for physician and hospital reviews that enable selection and fee negotiation. The provider retention rate returned to 80% during 2008, demonstrating Health Grades value to its customers.
The Company's business model is particularly attractive with a substantial leverage potential off a relatively fixed cost-base. Data acquisition is a one-time cost and the Health Grades' <i>Quality Rating Suite</i> of products can be licensed to numerous customers with nominal incremental cost per customer.
A solid balance sheet with no debt and substantial cash balances helps ensure ample resources for new product development and upgrades to meet the needs of the dynamic health care sector.

OPERATING PROJECTIONS							
	<u>2008A</u>	<u>1QA</u>	<u>2QA</u>	<u>3QA</u>	<u>4QE</u>	<u>2009E</u>	<u>2010E</u>
Sales	\$39.7	\$12.4	\$12.5	\$13.3	\$12.5	\$50.7	\$59.8
Net Inc	\$ 4.7	\$ 1.6	\$ 1.7	\$ 1.8	\$ 1.4	\$ 6.5	\$ 7.8
CFO	\$ 6.4					\$ 5.0	\$ 9.0
EPS	\$0.15	\$0.05	\$0.06	\$0.07	\$0.05	\$0.23	\$0.26

Dollars in millions except per share earnings. Fiscal year ends December.

MARKET CAPITALIZATION	
Shares Outstanding	29.8 ml.
Recent Price	\$4.16
Market Capitalization	\$124.0 ml.
+ Debt	-0- ml.
- Cash	14.2 ml.
Enterprise Value	\$104.8 ml.
Book Value	\$17.7 ml.
Working Capital	\$ 3.5 ml.
Dividend	Nil

Balance sheet figures as of 9/30/09.

INVESTMENT RETURNS		
	<u>HGRD</u>	<u>Industry</u>
Return on Equity	44.0%	16.0%
Return on Assets	13.0%	13.0%
Return on Capital	43.0%	15.0%

VALUATION	
Price/Sales	2.5 X
Price/Cash Flow	17.2 X
Price/Trl. 12-mo. EPS	19.8 X
Price/Book Value	7.0 X
Consensus EPS 2009	\$0.21
Forward PE	19.8 X
Consensus EPS 2010	\$0.28
Forward PE	14.9 X

Per share figures trailing twelve months.

Chart Courtesy StockCharts.com



MARKET DATA	
Recent Price:	\$4.16
52 week High / Low:	\$5.30-\$1.16
Shares Outstanding:	29.8 M
Inside Ownership:	14%
Institutional Ownership:	50%
Estimated Float:	25.7 M
Average Daily Volume:	120 K
Short Interest (% of float):	2.3%
Beta:	1.10

Source: Bloomberg, LP

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ANALYST

Debra Fiakas, CFA is a seasoned, credentialed investment professional with a diversified and successful track record as a research analyst and as an investment banker. Her decade-plus career includes solid experience in all aspects of the equity capital markets with particular emphasis on emerging growth companies operating in the technology sectors. Ms. Fiakas is also the principal member of Crystal Equity Research, LLC.

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The analyst who is primarily responsible for this research and whose name is listed first on this front cover certifies that: 1) all of the views expressed in this research accurately reflect his or her professional views about any and all of the subject securities or issuers, and 2) no part of any of the analyst's compensation was, is or will be directly or indirectly related to the specific rating expressed by analyst in this research.

RATING SYSTEM

- Buy Price appreciation expected 10% or more over a 12-month period.
- Hold Price appreciation/depreciation expected between 10% and -10% over 12 months.
- Sell Price depreciation expected 10% or more over a 12-month period.

CRYSTAL RESEARCH UNIVERSE

Buys	10	77%
Holds	2	15%
Sells	1	8%
Total	13	100%

HISTORICAL RECOMMENDATIONS AND TARGET PRICE: Health Grades, Inc. / HGRD

<u>Report</u>	<u>Date</u>	<u>Price</u>	<u>Rating</u>	<u>Target Price</u>
Initial	5/19/06	\$5.01	Buy	\$7.20
Update	8/1/06	\$4.25	Buy	\$7.20
Update	11/2/06	\$4.50	Buy	\$7.20
Update	12/21/06	\$4.23	Buy	\$7.20
Update	2/23/07	\$6.03	Buy	\$7.20
Update	5/10/07	\$6.10	Buy	\$7.20
Update	8/1/07	\$6.23	Buy	\$7.20
Update	10/31/07	\$6.42	Buy	\$7.50
Update	2/22/08	\$5.59	Buy	\$7.50
Update	4/30/08	\$5.17	Buy	\$7.50
Update	7/30/08	\$3.77	Buy	\$6.75
Update	10/30/08	\$2.09	Buy	\$5.50
Update	2/19/09	\$2.45	Buy	\$5.50
Update	4/23/09	\$1.98	Buy	\$5.50
Update	7/29/09	\$4.98	Buy	\$6.75
Update	10/29/09	\$4.16	Buy	\$6.75

DISCLOSURES

<u>Name</u>	<u>Symbol: Exchange</u>	<u>Disclosures</u>
Health Grades, Inc.	HGRD: Nasdaq	None

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- C A person or persons preparing this report or an immediate family member of the preparer has a beneficial interest in the common stock of the company.
- D Crystal Equity Research, LLC received compensation for research coverage from the company or one of its agents. The fees are paid in advance in cash.
- E The company has a convertible issue outstanding.
- F The securities covered in this report can be optioned.
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