Applied Investment Management (AIM) Program

AIM Class of 2013 Equity Fund Reports
Fall 2012

Date: November 30, 2012 Time: 2:30 pm – 3:30 pm
Road Show Location: Madison Investment Advisors
550 Science Drive, Madison

Student Presenter	Company Name	Ticker	Price	Page
Heinz Schelhammer	Mobile TeleSystems	MBT	$17.41	2
Max Michelson	Derma Sciences	DSCI	$11.33	5
Patrick Maag	Coinstar, Inc.	CSTR	$46.00	8
Greg Trunk	Greatbatch, Inc.	GB	$22.30	11

We appreciate the opportunity to take an AIM 'road show' to Madison Investment Advisors. These student presentations are an important element of the applied learning experience in the AIM program. The students conduct fundamental equity research and present their recommendations in written and oral format – with the goal of adding their stock to the AIM Equity Fund. Your comments and advice add considerably to their educational experience and is greatly appreciated. Each student will spend about 5-7 minutes presenting their formal recommendation, which is then followed by about 8-10 minutes of Q & A. Again, thank you for allowing us the opportunity to present Madison Investment Advisors.

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Mobile TeleSystems OJSC (MBT)
November 30, 2012

Heinz Schelhammer International Telecommunication Services

Mobile TeleSystems (NYSE: MBT) is a leading telecommunications provider in Russia and the Commonwealth of Independent States, providing a wide range of mobile and fixed line voice and data telecommunications services, as well as selling equipment and accessories. With a total subscriber base of 101.14 million at year end 2011, MBT was the largest mobile operator in Russia, Uzbekistan and Armenia, and the second largest in Ukraine. MBT has operations in Russia (86.3% of 2011 sales), Ukraine (9.3%), Uzbekistan (3.6%), Armenia (1.6%), and Turkmenistan (>1%). The firm was formed in 1993, and is based in Moscow, Russia.

Price ($): (11/26/12)	$	17.41
Price Target ($):	$	19.97
52 WK H-L ($):		20 - 14
Market Cap ($mil):	$	17,300
Float (mil):		430.4
Short Interest (%):		0.69%
Avg. Daily Vol. (3 mo):		2,688,550
Dividend ($):	$	0.76
Yield (%):		4.30%

Beta (vs SPADR):	0.785
WACC:	9.12%
M-Term Rev Gr. Rate Est:	7.45%
M-Term EPS Gr. Rat Est:	6.43%
Debt/Equity:	356%
ROE:	28.40%
ROA:	6.20%

FY:	2011 A	2012 E	2013 E
Revenue ($mil)	$12,319	$12,668	$13,686
% Growth	9.08%	2.84%	8.04%
Gross Margin	71.3%	72.1%	73.4%
EBITDA Margin	40.5%	35.7%	45.2%
EPS (Cal)	$ 0.73	$ 0.49	$ 1.09
FCF/Share	$ 0.52	$ 0.46	$ 1.31
P/E (Cal)	23.76	35.18	15.93
EV/EBITDA	4.95	5.46	3.99

Recommendation

Due to the combination of rising disposable incomes, increased business activity, and declining prices due to competition, the demand for wireless communication services in Russia has grown over 75% from 2006 through 2011. As of December 31, 2011, overall wireless penetration in Russia was approximately 156.8%, or 227.6 million subscribers. In Moscow and St. Petersburg, penetration rates have reached 212.1% and 215.6%, respectively, as of the end of 2011. MBT's market shares are 36.2% in Moscow and 30.7% in St. Petersburg. MBT's new management team (appointed since 2009) has refocused the company's strategy around the growing trend of higher-value subscribers from increased smart phone users, which has helped the average revenue per user (ARPU) return to 2009 levels. The recently appointed Russian communications minister Nikolay Nikiforov stated that his number-one priority would be to improve the network quality in order to build a more sustainable foundation for long-term growth. This coincides with the focus of MBT in their attempts to roll out 3G service to their users, and was also awarded a license to provide LTE services. MBT has shown superior ROE of 28.40% compared to their publicly traded Russian peer, Vimpelcom, which has an ROE of only 6.48%. This higher level of profitability also comes with Vimpelcom being on average 20% more expensive than peers, which have been cut down from 40% more expensive previously. It is recommended that MBT be added to the AIM International Equity fund with a target price of $19.97, an upside of 15%.

Investment Thesis

- **Strong Presence in Developing Economies.** Over 95% of 2011 revenue was generated in Russia and Ukraine, which are two of the stronger economies in Europe today. Russia saw Q3 2012 GDP grow 2.9% YoY, which was better than the 1.08% Eastern European average. Russia also has an unemployment rate of 5.2% which is below the 10.7% Eastern Europe average. Ukraine holds the lowest European unemployment rate at 1.5%.
- **Trend Towards Smart Phones.** With the shift from fixed line and basic mobile telephone services towards smart phones, the average revenue per user in Russia has gone up slightly over 8.5% over the past year, and is expected to continue increasing in the future. The percentage of Russian subscribers with smart phones has risen from 8.1% at the beginning of 2010 to 18.2% of all subscribers at the end of the latest quarter. The focus on smart phones has also increased the

average monthly data traffic per mobile Internet user from 75MB in Q1 2010 to 660MB in Q3 2012, a growth of almost 800%.

- **Change in Dividend Policy.** Currently, the firm aims to payout at least 50% of net income under U.S. GAAP to their shareholders in the form of dividends. Due to the volatility due to currency fluctuations, the firm has decided to devise a new policy that ties the dividend amount to free cash flow, which they believe provides a more clear picture. Management also recommends raising the total cumulative dividend at least 25%. This would raise the ADR dividend to around $1.17, a potential yield of 6.72%.

Valuation

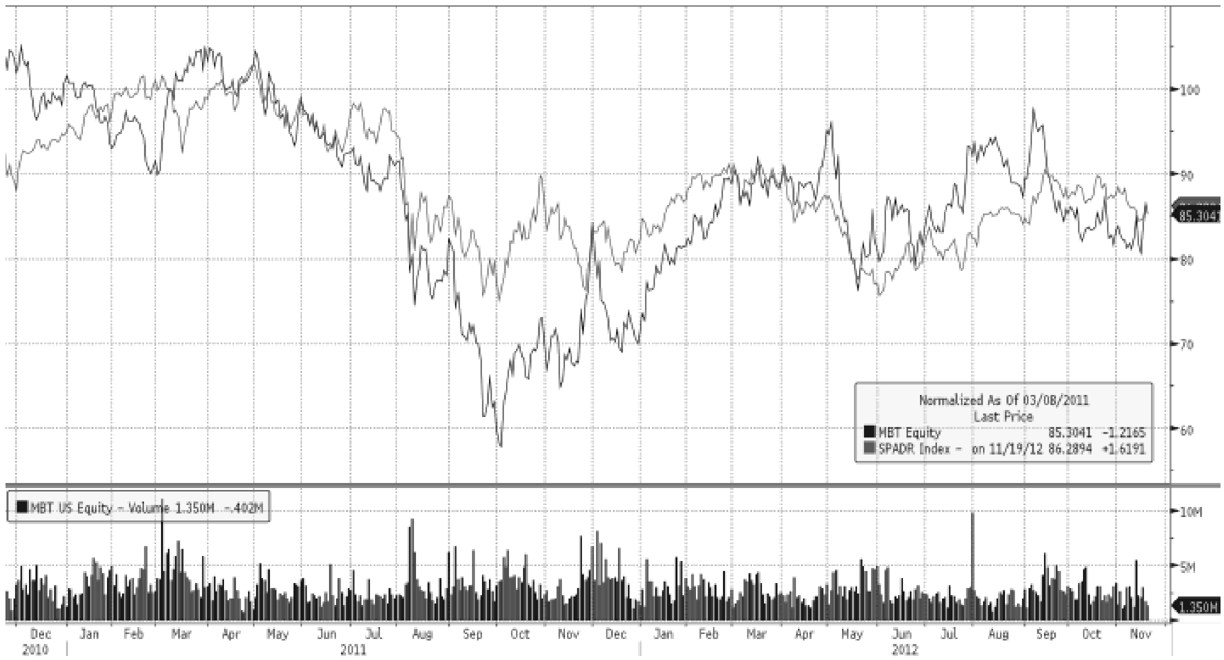
To find the intrinsic value of MBT, a ten-year DCF was conducted, and a price target of $23.21 was obtained. A sensitivity analysis was also conducted, with the discount rate varying from 8% to 10%, and a perpetuity growth rate varying from 2% to 4%, to give a range of $19.41 - $31.77. A P/E multiple was used with ten comparable competitors to arrive at an average multiple of 15.72, and applying this to the 2013 EPS estimate of $1.09 yielded a value of $17.18. Lastly, an EV/EBITDA multiple was used with the competitors to arrive at an average multiple of 5.23, and applying this to the 2013 EBITDA estimate of $6.2B arrived at a value of $16.27. Weighting the DCF, P/E, and EV/EBITDA methods by 50%, 25%, 25%, respectively, established an intrinsic price target of $19.97, representing a 15% upside. The firm currently pays a 4.30% dividend.

Risks

- **Highly Competitive Sector.** Due to the almost commoditized aspect of the telecommunications segment, MBT has to continue to show customers why it is a better option in this space that other competitors. Recently MBT was ranked 80th in BRANDZ Top 100 Powerful Brands, and was the first Russian company to join the ranks of the world's most powerful brands in 2008, and remain the top Russian brand.
- **Uncertain Regulatory Environment.** A significant portion of the market remains in state ownership, however there has been talk for some time by the Russian government to privatize its majority stake in Svyazinvest, the main regional carrier. Until this stake is eventually privatized, there will remain a risk that the state-owned carriers may receive more preferential treatment or have beneficial influence in further regulation and policy.
- **Exchange Rate Fluctuations.** Due to the firm operating in different countries, there remains a risk that extreme fluctuations in currency spot rates may negatively affect the company's operations. The current spot rate of 31.17 RUB/USD is near the 30 level that this rate has fluctuated around for the past 3.5 years. If this rate were to significantly appreciate, this would negatively affect the dividends paid out to the ADR shares.

Management

Ron Sommer, 63 years old, has served as Chairman of the Board since June 2009, and has also served as Chairman for Deutsche Telekom, President/COO for Sony Europa and Sony USA, and has been a board member for T-Mobile International, France Telecom, Blackstone Group, and Motorola. Andrei Anatolievich Dubovskov, 45, has served as President/CEO since May 2011.



Ownership

% of Shares Held by All Insider and 5% Owners:	>1%
% of Shares Held by Institutional & Mutual Fund Owners:	32%

Source: CNBC, Bloomberg

Top 5 Shareholders

Holder	Shares	% Out
Lazard Asset Management	57,316,209	5.55%
Capital Research	45,082,774	4.36%
BlackRock	21,125,543	2.04%
JP Morgan	17,023,947	1.65%
Vanguard Group, Inc.	15,191,846	1.47%

Source: Bloomberg

Derma Sciences (DSCI)

November 30, 2012

Max Michelson Healthcare

Derma Sciences (NASDAQ:DSCI) is a medical device company that provides a specific focus of wound and skin care products in three segments: advanced wound care, traditional wound care, and pharmaceutical wound care. Advanced wound care products include Medihoney dressings that are used for the management of non-chronic and hard-to-heal wounds, such as ulcers, burns, and post-operative wounds. Dermas Sciences also offers traditional wound care, such as gauze, sponges, bandages, non-adherent impregnated dressings, retention devices, paste bandages, and other first aid products. In addition, the company provides pharmaceutical wound care products that aid in wound healing and scar reduction. DSCI sells its products to doctors, clinics, nursing homes, hospitals, home healthcare agencies, and other institutions through direct sales representatives in the US, Canada, and the UK. It also sells in international markets indirectly, through retail channels, manufactures representatives, and independent distributors. Derma Sciences was founded in 1984 and is headquartered in Princeton, NJ.

Price ($) (11/23/12)	11.33	Beta:	1.24
Price Target ($):	18.50	WACC	19.50%
52WK Range ($):	11.89- 6.94	M-Term Rev. Gr Rate Est:	15.0%
Market Cap:	146.9M		
Float	4.16M	Debt/Equity	N/A
Short Interest (%):	7.4%	ROA:	-16.48%
Avg. Daily Vol:	48,886K	ROE:	-18.78%
Dividend ($):	N/A		
Yield (%):	N/A		

FY: December	2011A	2012E	2013E
Revenue (Mil)	$63	$73	$84
% Growth	10.90%	16.00%	15.00%
Gross Margin	30.00%	35.00%	36.00%
Operating Margin	-6.00%	-18.00%	-19.00%
EPS (Cal)	-$0.49A	-$1.04E	-$1.22E
FCF/Share	-$0.08	-$0.60	-$0.50
P/E (Cal)	N/A	N/A	N/A

Recommendation

The traditional and advanced wound care revenues have seen strong growth and solid margins. Derma Sciences has entered the market of advanced wound care with the acquisition of MedEffiency in 2012. Yet, the attention this company commands is due to a drug that is currently in the development pipeline. Derma Science is on the verge of creating a new local drug call DSC127. It has been working on this drug since it licensed it from the University of Southern California in 2007, when it showed results of increased wound heal and scar reduction rates – and positive studies have been published in major international advanced wound care journals. There have been no adverse side effects or safety concerns from any of the pre-clinical or FDA trials. The developing drug is applied locally. Because it is not systemic, the likelihood of side effects is greatly diminished. This drug is constructed utilizing peptides, which form proteins, and naturally "not well characterized," meaning scientists don't thoroughly understand the exact science behind it. This attribute makes it nearly impossible to make a generic version of the drug. DSCI currently stands with $22M in cash and short term investments which should provide enough capital to carry the firm through its next year. DSCI will most likely need financing before they are able to bring DSC127 to market and management has estimated that Phase 3 trials will cost an estimated $30 to $35M by the time studies have concluded. Due to the nature of the developing drug, competitors are virtually nonexistent on a comparable basis. Since this would be a completely different product to treat diabetic foot ulcers, its competition would be the current methods of treating the illness. Many of these products would become largely obsolete with the introduction of DSC127. For DSCI's other segments, most of its competitors are small companies that compete largely on a regional direct sales basis. It is recommended that DSCI be added to the AIM Equity Fund with a price target of $18.50, representing a 63% upside. The firm does not currently have a dividend.

Investment Thesis

- **DSC127.** Derma Sciences' soon-to-be flagship drug, DSC127, is a local gel-based pharmacological agent that has been shown to improve the healing properties of diabetic foot ulcers by more than 40% when compared to current treatments. Currently the drug showed promising results in Phase 2 clinical trial with the FDA and is expected to begin Phase 3 trial by the end of the 2012 calendar year. The drug is currently on schedule and is expected to conclude all FDA trials and become commercialized by 2016. The start of Phase 3 trial should provide an ample boost to the stock price as the year end approaches. The potential markets for DSC127 include $10 billion chronic wound market, $8 billion scar prevention/reduction market, $6 billion burn market, and $6 billion radiation and other wound markets.

- **Advanced Wound Care Segment.** In early 2012, Derma Sciences, Inc. announced the agreement to acquire MedEfficiency for $15 million in cash. MedEfficiency is a privately held company that sells a proprietary line of medical devices used for the treatment of diabetic foot ulcers. The company had $5.3 million in sales with gross margins of 60%. This encompasses Derma Sciences strategy to acquire a company that would supplement diabetic foot ulcer care with its future drug DSC127. This acquisition has contributed to the expansive growth in DSCI's Advanced Wound Care segment which has seen 68% YoY growth.

Valuation

To find the intrinsic value of DSCI, a 5-year DCF model was employed due to the unpredictability of the development and adoption of its new drug. A WACC of 9.60% was computed, but due to future costs of financing as well the uncertainty of the ability for the drug DSC127 to come to market, 10.00% was added to the WACC as a consequence, arriving at a 19.6% WACC. A mid-term growth rate of 17% was used with a terminal growth rate of 2.5%. An intrinsic value of $19.50 was determined with this method.

A multiples approach was conducted using EV/Sales, blending other bio-tech companies in a similar space as DSCI. A multiple of 4.5x was used, which achieved a share price of $20.47. To plan for a worst case scenario, where DSCI's pipeline drug DSC127 did not make it to market due to the small chance it would fail FDA approval, a DCF model of the company was constructed without the prospects of the new drug, only looking at what the traditional wound care and the advanced wound care product lines revenue streams. After evaluating the company on this isolated basis, a value of $8.25 per share was achieved, a potential downside of roughly 25%. Blending these metrics, a valuation of $18.50 per share was achieved, resulting in a 63% upside.

Risks

- **Clinical/Regulatory Risk.** While the recent clinical data from Phase 2 trial for DSC127 was strong, Derma Sciences is not yet guaranteed any approval from the FDA. Trial 3 must be completed; any delay or cancellation would adversely affect the outlook of the company, as the pipeline for the product would be slowed and/or cease. Derma Sciences also needs to submit a Non-Disclosure Agreement to the FDA before approval.
- **Licensed Technology.** Many of the drugs and technology used in DSCI's products are licensed from other vendors. This is especially critical to the advanced wound care segment. These technologies are licensed for a period of time and if they were not renewed, it would inhibit DSCI's ability to sell these products. Attached to the licensed agreements are royalty contracts as well as minimum sales responsibilities.
- **Financial Risk.** Much of internal spending is based on DSC127 and DSCI will need external financing before the drug comes to market. Earlier in 2012, DSCI completed an equity financing deal that raised $27 million in capital. A corporate partnership would be likely in the later stages of the trials, which would minimize this financial risk.

Management

Edward Quilty has served as CEO, chairman, and director since 1996. He has been responsible for the firm's recent success as well as serving at other publicly traded biopharmaceutical companies. Quilty has over 35 years of experience in the healthcare industry.

Ownership

% of Shares Held by All Insider and 5% Owners:	31%
% of Shares Held by Institutional & Mutual Fund Owners:	60%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
RA Capital Management, LLC	1,253,419	9.75
BAKER BROTHERS ADVISORS, LLC	1,208,857	9.40
Camber Capital Management, LLC	1,050,000	8.17
JENNISON ASSOCIATES LLC	938,300	7.30
FMR LLC	428,847	3.34

Source: Yahoo! Finance

Coinstar, Inc. (CSTR)
November 30, 2012

Patrick Maag Consumer Discretionary

Coinstar, Inc. (NASDAQ:CSTR) is a leading provider of fully automated retail solutions. The company operates three core businesses. The "Redbox" business offers customers kiosks where they can rent or purchase movies and videogames from self-service units, the "Coin" business allows customers to convert coin to cash or stored value products, and the "New Ventures" segment which focuses on developing innovative self-service concepts. The company operates approximately 42,400 kiosks in 29,300 locations such as grocery stores, mass retailers and convenience stores. The Coin segment consists of over 20,300 coin-counting kiosks. The New Ventures segment operated 53 test coffee kiosks at the beginning of the year but plans to have 500 by the end of 2012. The company was founded in 1993 and is currently headquartered in Bellevue, WA.

Price ($): (9/23/12)	46.00	Beta:	1.091	FY: Dec	2011A	2012E	2013E
Price Target ($):	63.80	WACC:	9.1%	Revenue (Mil)	1845.4	2216.3	2502.2
52WK H-L ($):	71.82 - 40.50	New Ventures Risk Prem.	1.0%	% Growth	28.47%	20.10%	12.90%
Market Cap (bil):	1.36	5yr Avg. Rev. Gr Rate Est:	12.2%	Gross Margin	30.5%	30.4%	30.3%
Float (mil)	29.7	5yr Avg. EPS Gr Rate Est:	13.5%	Operating Margin	11.4%	11.5%	11.4%
Short Interest (%):	35.82%	Debt/Equity:	74.8%	EPS (Cal)	$3.40	$4.75	$5.20
Avg. Daily Vol (mil):	1.402	2011 ROA:	7.6%	FCF/Share	$7.45	$4.42	$4.50
Dividend ($):	0.00	2011 ROE:	20.8%	P/E (Cal)	13.53	9.68	8.85
Yield (%):	0.0%			EV/EBITDA	6.96	3.30	3.10

Recommendation

CSTR revolutionized DVD rental, made counting coins much more convenient and has brought to market many other innovative ideas that provide meaningful services to customers of various age groups. In the Redbox segment, revenue has grown as a result of heavy investment and captured market share from brick and mortar stores. In Q3, Redbox gained 9.0% of DVD rental market share bringing its total to 44%. With the acquisition of Blockbuster kiosks and the departure of a main rival Netflix, CSTR has seized a large opportunity. Since 2009 with only $1.78 EPS, the company has improved operating margins while growing earnings to $3.40 in 2011. During the period CSTR has added over 120bps to operating margins and seen kiosk revenue climb from $35,000 per unit to $55,000 per unit over the period. CSTR's ability to generate strong cash flows also gives them the ability to invest in new ideas and expand. The company has also identified areas where their strengths can meet market demand such as ticket booths, dollar coffee kiosks and self-serve photo booths. These concepts leverage low-cost and convenience to engage consumers. The company has met or beaten the last 11 earnings consensus by an average surprise percentage of 44% which also leads me to recommend that the stock be added to AIM Equity Fund with a price target of $62.10.

Investment Thesis

- **New Ventures provides innovative offerings.** This segment of the firm is bringing two more developed ideas to market this year. First, Redbox Tickets attempts to capture more of the consumers' needs. The booth will allow the consumer to purchase both live entertainment as well as rental or take home entertainment. The $1 fee provides an attractive alternative to options such as StubHub or Ticketmaster, while also helping the customer discover live events and attractions in the area. Second, a partnership with Starbucks will bring Seattle's Best Coffee to consumers via kiosks that serve ground-to-order-coffee. Staying with the $1 convenience, the machines will serve 12 and 16 oz. cups of coffee along with specialty drinks such as mochas, cappuccinos and lattes. There will be 500 deployed by the end of 2012 in hopes of capturing some of the $28.5B out-of-home coffee market. Other concepts include photo self-service booths and refurbished electronics vendors.

- **Lack of competition in growing market.** As of 2010, the Entertainment Merchants Association estimated that the home entertainment market is $18.8B, while $16.3B of this was spent on movies. Rental accounts for 31% ($5.1b) of this segment which signals further room for growth. With competitor Blockbuster going bankrupt and major rival Netflix phasing out hard DVDs from their business model, competition for physical rental is dwindling. The flexibility that Redbox rentals provide and continued growth in unique customers make CSTR's main line of business sustainable. A weak movie slate recently has hampered results. Olympic viewership also cut into the company's peak season, which has temporarily dampened outlook.
- **CSTR offering fitting preference change.** CSTR has recognized that streaming content has become the focal point of the entertainment industry. The company has formed a joint venture with Verizon called "Redbox Instant." While gaining 9.4% market share in the DVD rental space in Q3, the streaming service will provide a subscription based platform. CSTR looks to remain dominant in a market that is not going anywhere soon while recognizing the importance of convenience to the consumer. Bigger name movie releases later this year will also help revive lackluster industry wide performance. The company's 44% market share will propel it into the streaming business with a large customer base and familiar brand.

Valuation

To find the intrinsic value of CSTR, a 5-year DCF was conducted and weighted 50% of the final value. Revenue growth started at 20% in 2012 and trended down to 8% in the fifth year. The DCF used a calculated WACC of 10.1% including a 100bps premium due to the success of New Ventures. This DCF yielded an intrinsic value of $62.68. A sensitivity analysis of WACC ranging from 9% to 12%, 1st and 5th year FCF ranging 10% and 20% respectively yielded an average intrinsic value of $61.50. Each was weighted 25%. The combination of the three methods came to intrinsic value of $62.10 representing a 35% upside. The company does not pay a dividend.

Risks

- **Purchase agreements with studios.** CSTR depends on relationships directly with studios for rights to distribute content. The firm has signed several 5-year deals with studios to purchase physical inventory as well as streaming rights. Some of these contracts put restrictions on how quickly Redbox can make DVDs available in kiosks. It is necessary for the company to maintain strong working relationships with the studios in order to cost effectively deliver content.
- **Retailer relationship dependency.** Redbox's top 3 revenue sources account for 44.7% of total revenue. Wal-Mart Stores, Walgreen Co. and The Kroger Company represent 17.5%, 16.0% and 11.2% of segment revenue. This share of the Redbox business increases the need to maintain good relationships with contracted retailers hosting kiosks. The company hopes to provide mutual benefit to retailers, but when the kiosks no longer provide benefit, retailers may terminate contracts in as early as 90-days' notice
- **Success of New Ventures.** The company's biggest growth opportunities come through the New Ventures segment. The streaming service, self-serve photo booths, coffee kiosks and refurbished electronics kiosk require significant investments and may not become profitable for the several quarters.

Management

CEO Paul Davis joined the company as COO in 2008 and became CEO in 2009. He has held executive positions in CPG and retail with Starbucks, Frito-Lay and Kettle Foods. Gregg Kaplan is President and COO who joined the company through the Redbox acquisition in 2009. He comes from a business development background with McDonalds Corporation.

Source: Bloomberg

Ownership

% of Shares Held by All Insider and 5% Owners:	1%
% of Shares Held by Institutional & Mutual Fund Owners:	>100%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
Goldman Sachs Group Inc.	2,912,827	9.65
Blackrock	2,403,689	7.96
Vanguard Group, Inc.	3,118,549	7.39
Fine Capital Partners	2,885,059	6.03
Artisan Partners Holdings	2,392,846	4.06

Source: Bloomberg

Greatbatch, Inc. (GB)
November 30, 2012

Greg Trunk | Healthcare

Greatbatch, Inc. (NYSE:GB) primarily provides components and design consultation to original equipment manufacturers (OEM) of medical and industrial application in addition to selling its own internally produced original equipment. The company is divided into three reporting segments of Greatbatch Medical (86% of revenue), Electrochemical (14%), and QiG (less than 1%). Greatbatch Medical designs and manufactures devices and components for the cardiac rhythm management and neuormodulation, vascular access, and orthopedic markets. Electrochemcial produces power cells for medical equipment in addition to industrial application. QiG is the firm's self-manufacturing arm which also focuses on research and development of critical new strategic products. The company was founded in 1970, went public in 2000, and is headquartered is in Clarence, New York.

					FY: December	2011A	2012E	2013E
Price ($)	22.30	Beta:	1.1		Revenue (Mil)	569	651	674
Price Taget ($):	28.74	WACC	8.0%		% Growth	6.6%	14.7%	3.5%
52WK Range ($):	19.31-27.22	M-Term Rev. Gr Rate Est:	8.0%		Gross Margin	31.7%	31.2%	32.1%
Market Cap:	528.4M	M-Term EPS Gr Rate Est:	8.0%		Operating Margin	10.9%	8.4%	11.8%
Float	23.2M	Debt/Equity	47.9%		EPS (Cal)	$1.42A	$0.14E	$1.52E
Short Interest (%):	4.4%	ROA:	4.0%		FCF/Share	$2.90	$2.83	$3.46
Avg. Daily Vol:	81.90 K	ROE:	7.4%		P/E (Cal)	15.79	12.69	12.10
Dividend ($):	N/A	Financial Leverage	1.85		EV/EBITDA	6.56	5.75	4.73
Yield (%):	N/A							

Recommendation

As a result of GB's manufacturing consolidation, promising product pipeline and resurgent growth in current markets GB will experience improving margins on an increasing revenue stream. GB's core business of Cardiac Rhythm Management (pacemakers) and Neuromodulation (50% of revenue) revolves around altering electrical simulation to avoid abnormality within a patient's own electrical system. In recent years the absence of product recalls and deferral of elective surgery has caused an industry wide 1%-4% decline within this $11B market. However, due to the limited life nature of the products, aging demographics, and increasing complexity the industry is expected to rebound towards 2%-4% growth. In addition, these same drivers of an aging population and increasing complexity are expected to cause Orthopedics (25% of revenue) and Vascular Solutions (7%) to experience long run growth of 8%-12% and 10%-15% respectively. Furthermore, GB's synergetic combination of product reliability and technological innovation ensure a formidable competitive advantage. This reputation for quality compared to its competitors enables GB to sign 3-7 year agreements with prominent OEM's such as Medtronic, Johnson & Johnson, Boston Scientific, and St. Jude Medical. Besides manufacturing components for OEM's GB is also increasingly developing its own products; most notably the AlgoStim product for spinal cord simulation (SCS). SCS products are used for patients with inoperable back pain and typically failed spinal fusions. The market is estimated at $1.5B and is projected to grow 14% annually with only GD, FD, and AFFD as participants. GB expects to hear approval from FDA in late 2013 and began launch sometime in 2014.

Investment Thesis

- **AlogStim Technological Superiority**-GB AlgoStim product will perform better than existing competitor offerings because of a superior lead system. Existing SCS leads are challenged by lead migration and breakage. Since these leads are used in the lumbar region of the body and leads in this region of the body need to withstand higher amounts of physical stress, product durability is critical. Evidence indicates that SCS can produce at least 50% pain relief in over half of the implanted patients. Furthermore, because of the spinal cord's key role with transmitting sensations throughout the body there is hope this pain relief could extend well beyond the initial target. The worldwide broadly defined pain relief industry is estimated at around $40B.

- **Platform Adoption-**The neurosimulation market is estimated to grow from $2B in 2012 to $7B in 2018 from an increasing adoption of diverse treatments. Neurostimulation involves the stimulation of various nerves in the central nervous system including the deep cell nuclei of the brain which leads to the modulation of its activity. Neurosimilators are currently commercialized for pain stimulation, urinary incontinence, obesity, and epilepsy. However the underlying homogenous medical underpinning of treatments leads to closely paralleled technological solutions. Through their AlgoStim device, GB believes it is possible they will be able to license this platform to companies who are attempting to treat these indications. By using the AlgoStim platform neurostimulator the sponsor will be able to reduce their time to market dramatically, lower development costs, and decrease regulatory risk with the FDA. According to a Stanford University study the estimated cost to bring a medical device to market is $30M and rival pharmaceuticals are roughly $1.3B according to an Eli Lilly spokesperson.
- **Manufacturing Consolidation-**Since the current CEO arrived in 2005 GB has consolidated its manufacturing facilities from 23 to 12 is expected to finish its consolidating phase during 2013. Currently the company is transferring manufacturing being performed at locations in Orvin and Corgemont, Switzerland into facilities in Fort Wayne, Indiana and Tijuana, Mexico at estimated cost of cost of $35-40M. Once manufacturing restructuring is completed operating margins are projected to increase by 4%-5% within two years. In addition to lowering costs these initiatives improve time to market for OEM customer while offering increased quality levels. The company's two recent design centers in Warsaw Indiana and France allow OEM engineers to work directly with GB engineers.

Valuation

To find the intrinsic value of AHS, a six year DCF and EV/EBITDA Approach was used. In the DCF approach an 8% growth rate was used in years 3-6, a 2% perpetual growth rate and a discount rate of 8% to find an intrinsic value of $30. A sensitivity analyses was conducted on gross margins, revenue growth, and research and development cost which yielded a valuation range of $16-$30. An EV/EBITDA multiple of 11 based upon competitors and GB's historical valuation yielded a $27 price. Based upon an equal weighting of the two methods an estimated price target of $28 was established, representing a potential upside of 26%.

Risks

- **Revenue Concentration-**Collectively, Medtronic, Johnson & Johnson, Boston Scientific, and St. Jude Medical accounted for approximately 59% of 2011 revenue. Though GB currently has multiyear contracts with all of these companies many of the contracts do not contain minimum purchase clause. GB's supply agreement with these companies may also not be renewed in the future.
- **Regulatory Risk-**The 2010 Health Care Reform Act imposes a 2.3% tax on the price of new medical devices. Though GB does not face large direct exposure to tax the large majority of its original equipment manufacturers will be negatively impacted. This may subsequently reduce demand for GB components used within medical devices. Other elements of Health Care Reform could alter the way healthcare is delivered in the future with unknown immediate consequences. Negative implications for GB as of yet unknown may occur within next few years as provisions are clarified.

Management

Thomas J. Hook holds the position of President and Chief Executive Officer. He joined GB after selling his own company CTI Solutions and his most recent job within the company was Chief Operating Officer. The president of the Greatbatch Medical segment is Mauricio Arellano while the electrochemical segment division is headed by Senior Vice President Susan M. Bratton.

Ownership

% of Shares Held by All Insider and 5% Owners:	2%
% of Shares Held by Institutional & Mutual Fund Owners:	> 99%

Source: Bloomberg

Top 5 Shareholders

Holder	Shares	% Out
Dimensional Fund Advisors, LP	1,987,057	8.39%
Blackrock Fund Advisors	1,069,331	7.99%
Vanguard Group	1,349,098	5.69%
LSV Asset Management	1,276,197	5.39%
Oppenheimer Funds	1,035,975	4.37%

Source: Bloomberg