



*Celebrating
100 Years*

Applied Investment Management (AIM) Program

AIM Class of 2011 Equity Fund Reports Spring 2011

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Novatel Wireless Inc. (NVTL)

February 2, 2011

Andrew Freedman

Domestic Hardware

Novatel Wireless, Inc. (NVTL) is a provider of wireless broadband access solutions for the mobile communications market. Its range of products include 3G, intelligent mobile hotspots (47% of Revenue), communications and applications software, universal serial bus (USB) modems (50%), embedded peripheral component interconnect (PCI) express mini card modems and wireless personal computer card and ExpressCard modems (3%) . Its global customer base consists of wireless operators, laptop PC and other original equipment manufacturers (OEMs), distributors and various companies in other vertical markets. Its customer base also includes wireless operators and other wireless market participants, such as Bell Mobility, Sprint PCS, Telefonica, Verizon Wireless, Virgin Mobile, Vodafone and OEM partners such as Dell. Novatel is headquartered in San Diego, CA.

Price (\$): (1/21/11)	7.28	Beta:	1.24	FY: Dec	2009A	2010E	2011E
Price Target (\$):	10.83	WACC	11.56%	Revenue (\$tho)	337,422	331,256	470,384
52WK H-L (\$):	5.46-11.53	3-5 Yr Rev. Gr Rate Est:	10.00%	% Growth	5.12%	-1.83%	42.00%
Market Cap (mil):	230.3	3-5 Yr EPS Gr Rate Est:	9.60%	Gross Margin	25.98%	20.19%	24.00%
Float (mil):	28.89	Debt/Equity:	0.00%	Operating Margin	0.82%	-5.56%	4.40%
Short Interest (%):	8.5	ROA:	NEG	Pro-Forma EPS (\$Cal)	0.09	-0.38	0.53
Avg. Daily Vol (tho):	1,235.69	ROE:	NEG	FCF/Share (\$Cal)	0.48	0.18	0.45
Dividend (\$):	0.00	5-Yr Projected PEG:	0.26	P/E (Cal)	78.78	NEG	13.73
Proj FCF Yield:	6.50%	Cash Per Share (\$):	4.26	EV/Sales	0.30	0.40	0.80

Recommendation

Novatel Wireless is a leader in wireless connectivity solutions with a reputation of being both an innovator and early-mover. The firm is widely recognized for its flagship 'MiFi' mobile device, which allows users to turn any area into a Wi-Fi hotspot at the push of a button. Novatel has experienced impressive growth with a ten-year revenue and earnings CAGR of 465% and 346%, respectively. This growth is largely attributed to a decade long secular trend in wireless technologies and improvements in mobile broadband infrastructure, devices and capabilities. NVTL's quality focus and R&D investment has allowed them to stay ahead in the development cycle and with a superior product. On 1/4/11 Sprint introduced a NVTL MiFi that is expected to replace direct competitors, Sierra Wireless 'Overdrive' which runs at high temperatures and has long boot times. Novatel currently finds itself at the bottom of the 3G product cycle, placing significant pressure on ASPs and margins. This is evident by 3Q10 adjusted gross margin of 19.5% which is 75 bps above historic trough levels. It is expected that gross margins will improve in FY11 and beyond as service providers make the transition to 4G and consumers demand faster access speeds. NVTL currently is debt free and management intends on maintaining a no debt structure, relying on operating cash flow and its \$183 million of cash reserves to fund operations and development. For the aforementioned reasons, it is recommended that Novatel Wireless be added to the AIM Equity fund with a target price of \$10.82, yielding a potential return of 49%.

Investment Thesis

- **Next-Gen Cycle Ramp.** Novatel is positioned to strongly benefit from an industry wide transition to 4G technology across all segments. Historically, the transition years after initial development resulted in y/y revenue growth of 55% and 97% in 2005 and 2007, respectively. Further, next-gen devices are higher up on the value chain and are characterized by stronger gross margins between 28% and 31%. Major wireless network providers (AT&T, Verizon, and Sprint) are currently in fierce competition with respect to the roll-out of their 4G network and device capabilities. Verizon and NVTL recently announced the availability of a 4G LTE MiFi to be released during the 1Q11. Being the first 4G capable device of its kind, this places competitive pressure on other networks and affirms Novatel's early-mover position.

- **Growth in Cellular and Mobile Broadband Modems.** According to ABI Research, the cellular and mobile broadband PC modem market is forecasted to grow at a CAGR of 22% over the next five years from \$8.2 billion in 2011 to \$18 billion by 2015. This is driven by greater attachment rates of embedded broadband access cards to mobile devices such as netbooks, tablets and e-book readers. Continuous improvements in access speed will perpetuate this trend and result in a more practical access channel for internet users on the go.
- **Enfora Acquisition and M2M Solutions.** Novatel's recent acquisition of Enfora, a leader in M2M solutions, represents their push to expand offerings and diversify its product portfolio. As of 3Q10, Enfora had TTM revenues of \$63 million with gross margins of approximately 36%. Novatel paid a little over 1x revenue or \$64.5 million in an all cash transaction. Management expects the acquisition to be immediately accretive and with little to no related cost increases. Infonetics research estimates that the M2M market will grow at a CAGR of 38% through 2014. Mobile M2M technology allows for the instantaneous disbursement and transfer of logistical information from source to central database, which benefits firms of all size through additional cost savings and product control.

Valuation

Based on a 5-year DCF analysis with a computed WACC of 11.56% and a terminal growth rate of 3%, an intrinsic value of \$8.49 was obtained for NVTL. A sensitivity analysis that adjusts the long-term growth rate (2-4%) and WACC (9-13%) generated a price range of \$7.25-\$12.21. Additionally, a historical EV/EBITDA multiple of 6x and 8x were used to calculate a price range of \$9.85-\$11.94. Novatel is currently trading at EV/Sales of 0.4x. Historically, this multiple during ramp cycles has averaged north of 1x; however, due to increased competition a conservative multiple of 0.8x was used to generate a price target of \$13.08. NVTL is currently trading at a forward P/E of 13.7x 2011 adjusted EPS of \$0.53. Applying a 15x multiple to 2011 EPS estimates suggests a fair value of \$8.20. Further, NVTL is currently trading at a P/S of 0.7x which is a discount to the industry average of 1.4x and below the historical average 1.2x. Applying a 1x P/S multiple on 2011 RPS estimates suggests a fair value of \$14.56. Applying an equal weighting to all five valuation methods provides a target price of \$10.83. With the stock currently trading around \$7.28, the \$10.83 price target would yield a 49% return.

Risks

- **Component Constraints.** There are currently industry wide component constraints, with management stating that they are relying on deliveries and orders more than what is on hand. Management also noted that lead-times have also stretched out over the buildup of their backlog. This being said, management seems confident in their abilities to control this issue and obtain their allocation in order to meet demand. It is also possible that NVTL could even benefit from this constraint through higher ASPs.
- **Limited Scale and Distribution.** 92% of 2009 revenues were derived from North American customers. Currently, the only other geographic segment that has the infrastructure in place to operate NVTLs products are located in developed Europe and certain Middle Eastern countries. While management is working to again expand their European presence after being forced out by pricing pressure, continued economic weakness is a severe head-wind. Additionally, the majority of all sales are conducted directly through NVTLs sales force team, with only a small portion from indirect distribution channels.
- **Reliance on Major Customers.** Approximately 68% of 2009 revenues were derived from the company's three largest end customers. Verizon Wireless, Hon Hai and Sprint PCS represented approximately 38%, 20.5% and 10.7%, respectively.

Management

Peter V. Leparulo has served as a director since May 2003 and as CEO since January 2003. Slim S. Souissi has served as Senior Vice President and Chief Technology Officer since 2004. Prior to joining Novatel in 2002, Dr. Souissi was Principal Staff Engineer in Motorola's research and development operation from November 1994 to May 200. Dr. Souissi holds 37 U.S. patents, all related to wireless technology.



Ownership

% of Shares Held by All Insider and 5% Owners:	1.00%
% of Shares Held by Institutional & Mutual Fund Owners:	86.25%

Source: Reuters

Top 5 Institutional Shareholders as of September 30, 2010

<u>Holder</u>	<u>Shares</u>	<u>% Out</u>
Royce & Associates, LLC	2,334,676	7.38
Vanguard Group, Inc.	1,522,384	4.81
Severn River Capital Management, LLC	1,390,528	4.40
BlackRock Fund Advisors	1,372,211	4.34
Perimeter Capital Partners LLC	1,293,462	4.09

Source: Reuters

Heartware International Inc. (HTWR)

February 2, 2011

Shannon Lawton

Healthcare

Heartware International Inc., (HTWR) is a world leader in developing, manufacturing and marketing state of the art mechanical circulatory support for treating advanced heart failure. HTWR specializes in one distinct area - Ventricular Assist Systems - a blood pump designed to provide circulatory support for patients with advanced (stage III and IV) heart failure. HTWR's products act as a blood pumping device for patients whose hearts are not strong enough to pump on their own. HTWR competes directly against publically traded Thoratec Corporation (THOR), who also specializes in the Ventricular Assist Device Market. The company's strategy is to develop relationships with leading heart centers and surgeons worldwide, providing training for the use of their product, thereby allowing HTWR to thrive in this underserved and growing market. Heartware was founded in 2008 and is headquartered in Farnham, MA. The company currently operates across the United States, Australia, and Europe, (40% domestic / 60% international mix).

Price (\$ (2/2/11))	91.95	Beta:	0.55	FY: Mar	2009A	2010E	2011E
Price Target (\$):	104.00	WACC	7.6%	Revenue (Mil)	24,172	36,258	43,509
52WK Range (\$):	33.27 - 99.10	L-Term Rev. Gr Rate Est:	3.0%	% Growth	7185.07%	50.00%	20.00%
Market Cap:	44.7B	L-Term EPS Gr Rate Est:	3.0%	Gross Margin	45.35%	45.00%	45.00%
Float	485.23M	Debt/Equity	0.0%	Operating Margin	-85.02%	-5.00%	-5.00%
Short Interest (%):	12.7%	ROA:	-18.2%	EPS (Cal)	-\$0.06A	-\$0.10E	-\$0.12E
Avg. Daily Vol:	0.137M	ROE:	-30.6%	FCF/Share	-2.24	0.13	0.16
Dividend (\$):	N/A			P/E (Cal)	N/A	N/A	N/A
Yield (%):	N/A			EV/EBITDA	N/A	N/A	N/A

Recommendation

Heartware's patented product line has significant growth opportunities as the number of Americans with heart failure surpasses 5M (20M worldwide). HTWR specifically targets stage III and stage IV heart conditions, which encompasses about 7M people (20% estimated to be able to utilize HTWR's heart device). Additionally the HeartWare System is used in patients with end-stage ventricular failure who are not candidates for cardiac transplants. Analyst estimates predict the Ventricular Assist Market to expand to \$1B by 2015 in the U.S. – which only represents a 25% penetration of the Ventricular Assist Device Market. Analysts expect the Ventricular Assist Device Market to grow at a CAGR of 23% through 2015. For FY 2009, HTWR experienced a 7,000%+ growth rate in revenue, (net losses were the result of high R&D costs). The company expects to become profitable by the end of 2012. The HeartWare System was responsible for 100% of the firm's revenue. Given the exceptional growth prospects and potential rapid market penetration of HTWR, it is recommended HTWR be added to the AIM Equity Fund with a target price of \$110, offering an upside of about 20%.

Investment Thesis

- **Products.** The HeartWare System is a miniaturized pumping device with the ability to pump 10 liters of blood per minute (bodies only need 5-6 liters). HTWR's HeartWare System is the only Ventricular Assist Device that allows for implanting without abdominal surgery, allowing a wider pool of patients to undergo implantation. The company currently manufactures batteries to power the implantation, which last up to 6 hours (each charger holds three batteries). Heartware is working to improve battery operation for the HeartWare System, thereby providing greater mobility for the patient. HTWR is expected to complete its new HeartWare Miniaturized Ventricular Assist Device, a smaller, battery pack-less device, in 2012. Launching this new device will increase HTWR's market share and provide top line growth. The new device will reduce complications (bleeding and thrombus), attract a wide patient pool and increase patients' post-surgery mobility. It will also allow children and smaller adolescent's to receive the device.
- **Market Penetration.** HTWR sees significant room to gain market share as it caters to a relatively underserved market. Over 600K new cases of heart failure are diagnosed each year; however

only 2K transplants are available each year driving demand for HTWR's products - on top of an aging American population. By adding three more sales members to the HTWR team, the company has plans to increase sales by partnering with cardiologists. International penetration continues to be a focus as well, in 2011. HTWR generates revenue in 16 countries generating just under \$10M in revenue FY 2009. HTWR expects to move into additional countries in Europe, specifically focusing on France.

- **Destination Therapy.** HTWR uses its Ventricular Assist Device for patients with no heart transplant eligibility. HTWR's HeartWare System recently received approval from the FDA to begin treating patients in end stage heart failure that most commonly do not qualify to receive a heart transplant due to age. Destination Therapy (DT) is on the rise – from June 2006 to June 2010 DT represented 11.5% of the Ventricular Assist Device Implant Market – and from January to June 2010, it represented 15% of the market. Enrollment for HTWR's DT device will begin with 450 patients at 50 U.S. hospitals. The only alternative for destination therapy is drug treatment, which is not very successful with a 12 month mortality rate of 75%. The trial success rate for Heartware's HeartWare System is 94% survival at 180 days and 91% projected survival at 360 days.

Valuation

Using a 10-year DCF with a computed WACC of 7.6% and a LT growth rate of 3%, an intrinsic value of \$110.99 was determined for HTWR. The DCF model grew revenues in the near term at an average of 40% per year and maintained operating margins at 50%. Recently, Heartware's revenue growth has been more than doubling due to the recent approval of product sales in Europe, by the EU. Applying a 52x EV/Sales to 2010E sales forecast of \$36M yields an intrinsic value of \$135 was calculated. Blending these two approaches a price target of \$110 was determined, which represents an approximate 20% return.

Risks

- **FDA Approval.** HTWR is subject to extensive government regulation, most notably FDA approval. Should the FDA decide not to give HeartWare Systems approval, (final FDA approval is expected to be granted in 2012) expected revenue from the U.S. market would not occur, resulting in significant net losses.
- **Competition.** Intense competition exists in the medical device industry. At \$1.184B, HTWR competes against experienced manufacturer (THOR \$1.54B) whose advanced technology and product diversity are advantageous in funding new ventures.
- **Exchange Rate Risk.** HTWR's international presence is a cause for concern with regards to changes in foreign exchange rates. Many analysts expect the U.S. dollar will continue with its downward trend through 2012. The company does not hedge any currency exposure.

Management

CEO Douglas Godshall has over 20 years of experience in the health care business. Mr. Godshall joined the Company in September 2006 as President and CEO, and became director in October 2006. Previously, he served many roles at Boston Scientific Corporation, including being President of Vascular Surgery at BSX, during 2005. During June of 2008 Dr. David Hathaway joined HeartWare as Chief Medical Officer. Dr. Hathaway has practiced medicine for more than 14 years before transitioning to the corporate side. In addition he served as a Clinical Associate and Cardiology Fellow at the National Institute of Health.



Ownership

% of Shares Held by All Insider and 5% Owners:	31%
% of Shares Held by Institutional & Mutual Fund Owners:	53%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
FMR LLC	1,385,909	9.99
Fidelity Growth Company Fund	1,137,101	8.20
Wellington Management Company, LLP	666,690	4.81
Janus Capital Management, LLC	642,467	4.63
Price (T. Rowe) Associates Inc.	604,071	4.36

Source: Yahoo! Finance