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## Cambridge Heart (Nasdaq/CAMH)

**BUY**                      **Maintain Buy; International market prospects improve**

*Cambridge Heart manufactures and markets cardiac diagnostic systems*

### Investment Highlights

1) Cambridge Heart has been busy this fall in international markets, first with regulatory approval in Mexico followed soon thereafter with the signing of a distribution partner in Singapore. In Mexico, the Company's first foray into Latin America, partner Mayerick S.A. will distribute the HearTwave II System (which includes software and sensors) as part of an agreement originally signed in August 2010. In Singapore, Cambridge Heart announced a distribution agreement with EO Medical, also for the HearTwave II system, and estimates this new market can be launched sometime next year following a six- to nine-month regulatory approval period. Cambridge Heart currently markets its systems in other Asian markets, most notably Japan.

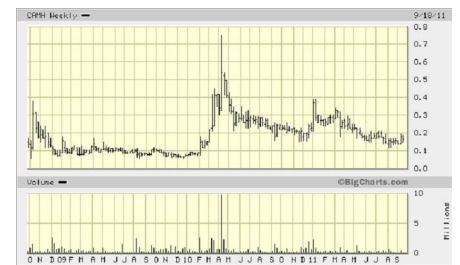
2) The Company recently reported their financial results for Q2/2011, posting revenues of \$542,000 versus \$654,000 in the prior year period, and a net loss of (\$1.4) million or (\$0.01) per share, versus a net loss of (\$1.4) million or (\$0.02) per share in the prior year period. Revenues were negatively impacted in the quarter by a switch in emphasis to marketing the OEM Module with partner Cardiac Science, away from sales of the HearTwave II system. Gross profit fell to \$126,000 in the quarter from \$223,000 in the prior year period due to the lower sales volumes, but the Company was able to compensate by reducing overhead expenses, with the net result being very comparable net losses year-over-year. Cash burn from operations during the quarter was approximately \$1.3 million, and the Company had close to \$1.6 million in cash at quarter end. Non-cash expenses were approximately \$160,000 during the quarter. Revenues declined for Alternans products both domestically and internationally, but stress and other products held nearly steady during the quarter.

3) For the calendar year as a whole, we are estimating that Cambridge Heart will post \$2.6 million in revenues, a decline of 8% year-over-year from 2010, and below our previous estimate of \$3.1 million, and incur a loss of approximately \$5.0 million, or (\$0.05) per share, as compared with a loss of \$5.2 million or (\$0.07) per share in 2010. Our estimates for 2011 encompass a 30% gross profit margin, R&D costs of \$570,000 (equal with 2010 levels), other overhead expenses of \$5.2 million (down from \$5.4 million in 2010), and shares outstanding of 98.5 million.

**Current Price**                      **\$0.15**

**Price Target**                      **\$0.50**

Estimates	F2009A	F2010A	F2011E
Revenue(\$000s)	\$3,232	\$2,819	\$2,600
1Q March	836	658	637 A
2Q June	793	654	542 A
3Q September	798	793	
4Q December	805	715	
Prev. Rev. Estimate (\$000s)			\$3,100
EPS	(\$0.12)	(\$0.07)	(\$0.05)
1Q March	(0.03)	(0.02)	(0.01) A
2Q June	(0.03)	(0.02)	(0.01) A
3Q September	(0.03)	(0.01)	
4Q December	(0.03)	(0.02)	
Previous EPS Estimate			(\$0.04)
P/E (x)	N/A	N/A	N/A
EBITDA/Share	(\$0.10)	(\$0.06)	(\$0.05)
EV/EBITDA (x)	N/A	N/A	N/A
<b>Stock Data</b>			
52-Week Range			\$0.12-\$0.39
Shares Outstanding (mil.)			98.5
Market Capitalization (mil.)			\$14.8
Enterprise Value (mil.)			\$13.2
Debt to Capital (6/11)			N/A
Book Value/Share (6/11)			N/A
Price/Book			N/A
Average Trading Volume (3-month)			64,400
Insider Ownership			23.3%
Institutional Ownership			1.4%
Short interest			15,000
Dividend / Yield			\$0.00/0.0%



Price target and ratings changes over the past 3 years:  
Initiated - July 19, 2010 - Buy - Target \$0.50

4) Despite the recent reduced quarterly results, we there are still several reasons to be optimistic regarding the Company's long-term outlook, in addition to the recent strides in the international market. In July, Cambridge Heart announced an agreement with Cardiac Science to include the new MTWA module (at no charge) on every new Q-Stress System sale through the end of 2011 – a strategy which management expects to expand the number of Modules in place significantly and lead to higher sales next year – especially of higher margin sensors and other disposables. The Company also continues to move ahead with its cardiac ischemia MTWA application pilot study, with 122 patients (as of August 15<sup>th</sup>) already enrolled at two clinical sites in this 200-patient trial. Enrollment is expected to be completed soon with full data analysis still on track to be completed by the end of 2011. Cambridge Heart is also making headway in obtaining reimbursement coverage for its MTWA test, and in June revealed that UnitedHealth Group (NYSE/UNH/Not Rated) made MTWA testing a covered benefit for its 32 million UnitedHealthcare US HMO enrollees. UnitedHealthcare follows other large providers covering the MTWA test, including Aetna (NYSE/AET/NR), Humana (NYSE/HUM/NR), Cigna (NYSE/CI/NR), several Blue Cross Blue Shield plans as well as Medicare. Finally, and additional reimbursement helps in this effort, Company management continues to seek additional OEM partners for its MTWA module, including leading players in the stress test markets such as General Electric (NYSE/GE/Not Rated), US-based Welch Allyn (Private) or Swiss-based Schiller AG (Private).

## Conclusion/Stock Valuation

Cambridge Heart made solid progress in 2010, and although continued progress has been slow to materialize so far in 2011, we believe there are several key catalysts remaining over the next 12-18 months to entice investors in becoming re-energized with the prospects for appreciation of CAMH shares. Thus, we are maintaining our BUY rating on shares of CAMH and 18-24 month price target of \$0.50, still below trading ranges of just last year, and representing approximately 19X this year's forecasted revenues of over \$2.6 million and a potential valuation also similar to the buy-out enterprise value recently received (in cash) for partner Cardiac Science.

## Catalysts/Investor Timeline

- 1) Launch of Cardiac Sciences OEM Module – late Q3/2010
- 2) Q3/2011 financial results announced – mid-November 2011
- 3) Additional OEM partnerships signed for MTWA module – 2011-2012
- 4) Completion of enrollment in ischemia trial – late 2011
- 5) Full data analysis of ischemia trial – end of year 2011
- 6) New international distribution partners for HearTwave II product line – 2011/2012
- 7) New strategic initiative for MTWA technology (drug development/clinical trials) – 2011/2012

## Risk Factors

We believe an investment in Cambridge Heart involves the following risks:

- **FDA and regulatory risks** – Cambridge Heart is subject to regulatory review for its ongoing research and development activities, principally the US Food and Drug Administration's 510 (k) application process but also with other regulatory agencies as well, including in Europe and Asia. In addition, the manufacture and testing of the Company's OEM modules, testing systems and sensors are subject to additional oversight and regulation by the FDA on an ongoing basis.
- **Reliance on marketing partners and distributors** — Currently, Cambridge Heart has relied heavily but not exclusively on marketing partnerships with St. Jude Medical in the US and distributors in Europe and Asia, especially Japan. Most recently, the Company has signed a marketing partnership in the US with Cardiac Sciences for an MTWA OEM module, launched last year, and hopes to sign additional partnerships in the future in a similar vein. Should any of the Company's major partners or distributors experience financial difficulty or a change in business

strategy (through a merger, for example) CAMH's near-term revenues could suffer a downturn. The Company's client list still remains very diverse, even with large partners, which may soften the negative effect of a loss of a key partner in the future.

- **Uncertain reimbursement environment** – Current depressed economic conditions have caused a great deal of concern and debate among federal and state executives and legislatures regarding budgetary issues, including the potential need for reductions in reimbursement levels for Medicare and Medicaid expenditures going forward. Any reductions in the levels of reimbursement rates for cardiac testing or other, related procedures and services could adversely affect Cambridge Heart's revenues and margins going forward.
- **Reliance on International sales** – Recently, Cambridge Heart announced regulatory approval for marketing its HearTwave II system in Mexico and a distribution agreement for this same product in Singapore, although marketing approval is still needed in that country before sales can commence. International sales entail a number of risks in addition to risks related to domestic sales, such as foreign currency translation risks, political risks, and risks stemming from the exclusive use of outside distributors.
- **Need to raise additional capital** – Cambridge Heart is currently not operating at a profit or with positive cash flow, and is not expected to do so in the near future, thus possibly requiring the need to raise additional capital in the next 3-6 months.

**Cambridge Heart, Inc.**  
**Consolidated Statements of Operations**  
(In 000s, except per share data)

FYE December	2006	2007	2008	1Q09	2Q09	3Q09	4Q09	2009	1Q10	2Q10	3Q10	4Q10	2010	2011E
				March	June	September	December		March	June	September	December		
Revenue	\$15,654	\$12,992	\$4,239	\$836	\$793	\$798	\$805	\$3,232	\$658	\$654	\$793	\$715	\$2,819	\$2,600
Cost of goods sold	7,001	5,646	3,179	493	463	456	430	1,842	510	431	535	498	1,974	1,820
Gross Profit	8,653	7,346	1,060	343	330	342	374	1,390	149	223	258	216	845	780
Operating Expenses:														
Research and development	1,763	1,863	542	74	92	92	123	381	148	155	120	153	576	570
Selling, general & administrative	2,701	3,081	10,847	2,433	2,018	1,932	1,998	8,380	1,451	1,435	1,259	1,288	5,433	5,200
Total operating expenses	4,464	4,944	11,389	2,507	2,110	2,023	2,120	8,761	1,599	1,590	1,378	1,441	6,009	5,770
Income (loss) from operations	4,189	2,402	(10,329)	(2,165)	(1,780)	(1,681)	(1,746)	(7,371)	(1,450)	(1,367)	(1,121)	(1,225)	(5,163)	(4,990)
Interest income	(35)	(20)	347	12	2	1	15	30	0	0	0	5	6	5
Interest expense & other	50	64	(48)	(2)	(2)	(2)	(109)	(115)	(1)	(4)	(3)	(3)	(11)	(10)
Income (loss) before tax	4,204	2,446	(10,030)	(2,155)	(1,779)	(1,681)	(1,840)	(7,456)	(1,451)	(1,371)	(1,123)	(1,222)	(5,168)	(4,995)
Provision for income taxes	(58)	369	0	0	0	0	0	0	0	0	0	0	0	0
Net income (loss)	4,262	2,077	(10,030)	(2,155)	(1,779)	(1,681)	(1,840)	(7,456)	(1,451)	(1,371)	(1,123)	(1,222)	(5,168)	(4,995)
Basic income per share	\$0.43	\$0.20	(\$0.16)	(\$0.03)	(\$0.03)	(\$0.03)	(\$0.03)	(\$0.12)	(\$0.02)	(\$0.02)	(\$0.01)	(\$0.02)	(\$0.07)	(\$0.05)
Diluted income per share	\$0.40	\$0.20	(\$0.16)	(\$0.03)	(\$0.03)	(\$0.03)	(\$0.03)	(\$0.12)	(\$0.02)	(\$0.02)	(\$0.01)	(\$0.02)	(\$0.07)	(\$0.05)
Basic shares outstanding	10,013	10,183	64,543	64,543	64,543	64,602	64,609	64,575	65,296	69,663	75,913	78,422	72,323	98,500
Diluted shares outstanding	10,612	10,183	64,543	64,543	64,543	64,602	64,609	64,575	65,296	69,663	75,913	78,422	72,323	98,500
Key ratios:														
Revenue growth	34.4%	-17.0%	-67.4%	-29.0%	-14.5%	-28.9%	-20.5%	-23.8%	-21.2%	-17.6%	-0.7%	-11.2%	-12.8%	-7.8%
Gross margin	55.3%	56.5%	25.0%	41.0%	41.7%	42.9%	46.5%	43.0%	22.6%	34.1%	32.5%	30.3%	30.0%	30.0%
R&D/revenue	11.3%	14.3%	12.8%	8.9%	11.6%	11.5%	15.2%	11.8%	22.5%	23.7%	15.1%	21.4%	20.4%	22.0%
S G & A/revenues	17.3%	23.7%	255.9%	291.2%	254.4%	242.0%	248.2%	259.3%	220.4%	219.6%	158.8%	180.3%	192.7%	200.0%
Depreciation, amort, non-cash comp	\$320	\$400	\$399	\$524	\$99	\$152	\$164	\$939	\$496	\$236	\$208	\$160	\$1,100	\$500
Operating margin	26.8%	18.5%	-243.7%	-259.1%	-224.4%	-210.6%	-216.9%	-228.1%	-220.3%	-209.2%	-141.4%	-171.4%	-183.2%	-191.9%
Cash Flow/share	\$0.43	\$0.24	(\$0.15)	(\$0.03)	(\$0.03)	(\$0.02)	(\$0.03)	(\$0.10)	(\$0.01)	(\$0.02)	(\$0.01)	(\$0.01)	(\$0.06)	(\$0.05)
EBITDA/share	\$0.42	\$0.28	(\$0.15)	(\$0.03)	(\$0.03)	(\$0.02)	(\$0.03)	(\$0.10)	(\$0.01)	(\$0.02)	(\$0.01)	(\$0.01)	(\$0.06)	(\$0.05)

**Balance Sheets**
**Quarterly Earnings Comparisons**

Assets:	(\$000s)	
	12/31/10	6/30/11
Cash and equivalents	\$4,188	\$1,592
Restricted cash	100	100
Accounts receivable, net	481	346
Inventory	686	676
Prepaid expenses & other current	95	49
Total current	5,550	2,764
Fixed assets	191	215
Restricted cash	300	200
Other assets	50	49
<b>TOTAL ASSETS</b>	<b>\$6,091</b>	<b>\$3,228</b>
Liabilities:		
Accounts payable	\$422	\$324
Accrued expenses	1,026	803
Capital leases	5	6
Total current	1,453	1,133
Capital leases	29	26
Total liabilities	1,481	1,159
Convertible preferred stock	12,871	12,815
Stockholders' equity	(8,261)	(10,746)
<b>TOTAL LIAB &amp; EQ</b>	<b>\$6,091</b>	<b>\$3,228</b>

	Revenues (in \$Mill)				
	March	June	September	December	Total
2008	\$1,177	\$927	\$1,122	\$1,012	\$4,239
2009	836	793	798	805	3,232
2010	658	654	793	715	2,819
2011E	637	542			2,600
	Earnings per Share				
	March	June	September	December	Total
2008	(\$0.04)	(\$0.04)	(\$0.03)	(\$0.05)	(\$0.16)
2009	(0.03)	(0.03)	(0.03)	(0.03)	(0.12)
2010	(0.02)	(0.02)	(0.01)	(0.02)	(0.07)
2011E	(0.01)	(0.01)			(0.05)

**Operating Statistics**

	2007	2008	2009	2010	2011E
<b>Sales by Region (\$000s)</b>					
US	\$9,445	\$3,569	\$2,770	\$2,249	\$2,100
Rest-of-world	662	670	462	571	500
Total	\$10,106	\$4,239	\$3,232	\$2,819	\$2,600
<b>Sales by Product Line (\$000s)</b>					
Alternans	\$8,910	\$3,135	\$2,281	\$1,800	\$1,700
Stress and other products	1,196	1,103	950	1,019	900
Total	\$10,106	\$4,239	\$3,232	\$2,819	\$2,600

Source: Dawson James Securities, Inc. estimates; Company documents

## Important Disclosures:

### Price Chart:



### Price target and ratings changes over the past 3 years:

Initiated – July 19, 2010 – Buy – Price Target \$0.50

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Ratings Distribution	Company Coverage		Investment Banking	
	# of Companies	% of Total	# of Companies	% of Totals
Buy	27	84%	8	30%
Neutral	4	13%	3	75%
Sell	1	3%	0	0%
Total	32	100%	11	34%

## Information about valuation methods and risks can be found in the “STOCK VALUATION” and “RISKS” sections of this report.

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