

May 20, 2010

**HealthTronics (Nasdaq/HTRN)**

**Robert M. Wasserman**

Director of Research

561-208-2905

rwasserman@dawsonjames.com

**Neutral Q1/10 Solid; Downgrading on Buyout**

*HealthTronics manufactures and operates urological treatment systems*

**Investment Highlights**

1) HealthTronics reported very quiet Q1/2010 results last week, in a 10Q filed with the SEC. The Company earned \$0.05 per share on revenues of \$48.4 million, versus \$0.01 per share on revenues of \$43.6 million in Q1/2009. The 11% revenue growth this year was led by acquisition-related increases from the mid-2009 Endocare acquisition, as well as smaller increases in revenues from laboratory services and lithotripsy operations. Our estimates for the quarter had been very close to actual; earnings of \$0.05 per share on revenues of \$49.0 million. Positive earnings trends for the quarter were led by an improvement in gross margins, as cost of services declined to 46.5% from 48.9%. Although other overhead expenses rose this year, the improved margins combined with a lower tax rate and lower minority interest costs as business trended away from partnership models were enough to produce the improved earnings results. Our estimate of Adjusted EBITDA for HealthTronics for the quarter was \$7.9 million versus \$5.5 million in Q1/2009. Operating cash flow was \$16.3 million in Q1/2010 as compared with \$15.8 million in Q1/2009. The Company had \$5.6 million in cash on hand at March 31<sup>st</sup>, along with approximately \$42.9 million in long-term debt.

2) Company management did not provide an update on guidance for the full year 2010; however, do to the on-target results for Q1/2010 we feel confident in maintaining our revenue estimates for 2010 at \$205 million (up 11% year-over-year) while increasing our GAAP earnings estimates to \$0.21 per share from \$0.18, primarily due to better-than-expected margins as the integration of Endocare continues to perform well. We estimate that adjusted EBITDA will increase to \$35.3 million for HealthTronics for 2010 from \$26.6 million.

3) The Company's 10Q did not provide detail on the progress of ongoing development projects such as laboratory services, IGRT de novo build-outs, or new technology/device pilot programs, but given the positive quarterly results we are assuming HealthTronics is proceeding as planned with its growth initiatives as the merger with Endo

**Current Price \$4.79**

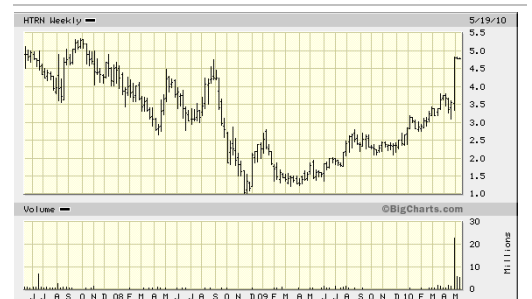
**Price Target N/A**

Estimates	F2008A	F2009A	F2010E
<b>Sales(\$000s)</b>	<b>\$165,942</b>	<b>\$185,330</b>	<b>\$205,289</b>
1Q	33,954	43,612	48,389 A
2Q	42,580	44,156	50,300 E
3Q	44,771	47,283	52,300 E
4Q	44,637	50,279	54,300 E
Prev. Rev. Estimate (\$000s)			<b>\$205,500</b>

EPS (non-GAAP)	\$0.10	\$0.16	\$0.25
1Q	0.01	0.03	0.06 A
2Q	0.02	0.03	0.06 E
3Q	0.04	0.05	0.07 E
4Q	0.03	0.06	0.07 E
Previous EPS Estimate			<b>\$0.26</b>
P/E (x)	49.3	29.3	19.0

EBITDA/Share	\$0.47	\$0.68	\$0.80
EV/EBITDA (x)	12.0	8.4	7.1

Stock Data	
52-Week Range	\$1.35-\$4.83
Shares Outstanding (mil.)	44.0
Market Capitalization (mil.)	\$210.9
Enterprise Value (mil.)	\$250.2
Debt to Capital (3/10)	25.2%
Book Value/Share (3/10)	\$3.02
Price/Book	1.6 x
Average Trading Volume (3-Month)	560,000
Insider Ownership	12.6%
Institutional Ownership	50.8%
Short interest	58,100
Dividend / Yield	\$0.00/0.0%



Price target and ratings changes over the past 3 years:  
Initiated - September 18, 2009 – Target \$3.75  
Downgraded to Neutral - May 20th, 2010

Pharmaceuticals progresses.

## Conclusion/Stock Valuation

We are lowering our rating on HealthTronics share to a Neutral as the share price has met and exceeded our original price target, but will maintain coverage until the acquisition is complete in the case of unforeseen circumstances. We do not believe that HealthTronics' business prospects will suffer in the interim, in part due to the strong recent first quarter results, and in fact may even benefit by an opportunity to look into possible joint ventures such as with Medical Enterprises Group (recently acquired by Endo) in the bladder cancer area. With estimated non-GAAP earnings of \$0.25 per share for 2010, HTRN shares still trade at under 20x this year's earnings, and are thus not overpriced at today's buy-out price trading range.

## Risk Factors

HealthTronics has been very active on the **acquisition** front, making three large and several smaller deals in 2008 in several different business segments and another major acquisition in 2009. Although the Company has made acquisitions before, the size and volume of recent acquisition activity may continue to pose an integration test for the Company's management team. In addition, the Company has dipped into its line of credit in 2008 to complete the most recent acquisition of Ocean and in 2009 for Endocare, and although HealthTronics has approximately \$15 million remaining on its \$60 million revolving line of credit and has all of its \$125 million senior secured term loan B untapped, Company management and its Board may not wish to expand indebtedness in the near-term even if an attractive acquisition opportunity arises. Finally, like many other healthcare service providers, HealthTronics is reliant on **government reimbursement programs** for its lithotripsy and prostate business revenues, and any changes to the amount or nature of this reimbursement could negatively impact future operating results. On October 1, 2009 a recently issued rule by the US Centers for Medicare & Medicaid Services (CMS) barring certain physician-owned ventures from contracting with hospitals under a per-procedure or per-click payment arrangement became effective. CMS has acknowledged that lithotripsy services is exempt from the Stark Law described above, but other services provided by the Company under physician partnerships including cryoblation and laser BPH surgery have not yet been exempted, and should implementation of the Stark Law be actively pursued by the Federal CMS agency in the near future, HealthTronics could be required to re-structure many of its existing relationships in non-lithotripsy areas. Finally, current trading ranges of HTRN share price are set based on the recent buy-out proposal from Endo Pharmaceuticals, and should this agreement be rescinded or amended, shares could decline to earlier levels before the agreement was reached.

**Healthtronics, Inc.**  
**Consolidated Statement of Earnings**  
 (in \$000s, except EPS)

Robert M. Wasserman

Calendar Year	2004	2005	2006	2007	2008	1Q09	2Q09	3Q09	4Q09	2009	1Q10	2Q10E	3Q10E	4Q10E	2010E
<b>Revenues</b>															
Urology Services	75,361	133,360	123,265	122,736	145,265										
Medical Products	10,846	18,202	19,080	17,101	20,389										
Other	936	705	546	581	288										
<b>Total</b>	<b>87,143</b>	<b>152,267</b>	<b>142,891</b>	<b>140,418</b>	<b>165,942</b>	<b>43,612</b>	<b>44,156</b>	<b>47,283</b>	<b>50,279</b>	<b>185,330</b>	<b>48,389</b>	<b>50,300</b>	<b>52,300</b>	<b>54,300</b>	<b>205,289</b>
<b>Costs and expenses:</b>															
Urology services costs			51,262	53,490	65,185										
Medical products costs			16,797	11,225	10,494										
Total cost of services			68,059	64,715	75,679	21,307	21,256	22,452	25,645	90,660	22,468	23,140	23,800	25,520	94,928
Salaries, general & admin			20,298	15,884	20,006	4,556	4,860	7,290	7,340	24,046	6,317	6,290	6,280	6,520	25,407
Deprec. & amort.			11,275	11,107	12,363	3,478	3,398	3,737	3,931	14,544	4,009	4,100	4,200	4,300	16,609
<b>Total</b>	<b>51,274</b>	<b>86,325</b>	<b>99,632</b>	<b>91,706</b>	<b>108,048</b>	<b>29,341</b>	<b>29,514</b>	<b>33,479</b>	<b>36,916</b>	<b>129,250</b>	<b>32,794</b>	<b>33,530</b>	<b>34,280</b>	<b>36,340</b>	<b>136,944</b>
<b>Operating income (loss)</b>	<b>35,869</b>	<b>65,942</b>	<b>43,259</b>	<b>48,712</b>	<b>57,894</b>	<b>14,271</b>	<b>14,642</b>	<b>13,804</b>	<b>13,363</b>	<b>56,080</b>	<b>15,595</b>	<b>16,770</b>	<b>18,020</b>	<b>17,960</b>	<b>68,345</b>
<b>Other income:</b>															
Interest income	319	448	755	1,146	1,233	50	32	13	6	101	36	40	40	40	156
Interest expense	(650)	(1,139)	(1,146)	(829)	(1,077)	(290)	(298)	(299)	(689)	(1,576)	(506)	(450)	(400)	(350)	(1,706)
Income from cont. operations	35,538	65,251	42,868	49,029	58,050	14,031	14,376	13,518	12,680	54,605	15,125	16,360	17,660	17,650	66,795
Minority Interest	27,030	47,816	43,277	45,568	54,259	13,328	13,741	14,472	14,143	55,684	12,489	13,000	13,500	14,000	52,989
Income tax	3,247	6,502	(4,563)	(2,854)	(11,516)	313	306	1,348	870	2,837	315	1,290	1,600	1,410	4,615
Net income before ex. item	5,261	10,933	4,154	6,315	15,307	390	329	(2,302)	(2,333)	(3,916)	2,321	2,070	2,560	2,240	9,191
Extraordinary items	3,908	1,745	(4,529)	20,947	144,000	0	0	0	0	0	0	0	0	0	0
Net income	1,353	9,188	8,683	(14,632)	(128,693)	390	329	(2,302)	(2,333)	(3,916)	2,321	2,070	2,560	2,240	9,191
Basic earnings per share	\$0.06	\$0.27	\$0.25	(\$0.41)	(\$3.58)	\$0.01	\$0.01	(\$0.06)	(\$0.05)	(\$0.09)	\$0.05	\$0.05	\$0.06	\$0.05	\$0.21
Diluted earnings per share	\$0.06	\$0.26	\$0.25	(\$0.41)	(\$3.58)	\$0.01	\$0.01	(\$0.06)	(\$0.05)	(\$0.09)	\$0.05	\$0.05	\$0.06	\$0.05	\$0.21
Earnings per share - non-GAAP						\$0.03	\$0.03	\$0.05	\$0.06	\$0.16	\$0.06	\$0.06	\$0.07	\$0.07	\$0.25
Shares outstanding - basic	21,903	34,311	35,157	35,420	36,498	35,892	36,006	41,043	43,491	39,108	43,665	43,800	44,000	44,200	43,916
Shares outstanding - diluted	22,201	35,182	35,347	35,423	36,550	35,966	36,161	41,043	43,491	39,165	44,038	44,200	44,400	44,600	44,310
<b>Key ratios:</b>															
Revenue Growth	41.8%	74.7%	-6.2%	-1.7%	18.2%	28.4%	3.7%	5.6%	12.6%	11.7%	11.0%	13.9%	10.6%	8.0%	10.8%
Cost of Urology services			41.6%	43.6%	44.9%										
Cost of Medical products			88.0%	65.6%	51.5%										
Cost of services - total					45.6%	48.9%	48.1%	47.5%	51.0%	48.9%	46.4%	46.0%	45.5%	47.0%	46.2%
S, G&A/Revenues			14.2%	11.3%	12.1%	10.4%	11.0%	8.7%	8.6%	13.0%	13.1%	12.5%	12.0%	12.0%	12.4%
Tax Rate	38.2%	37.3%	N/A	N/A	41.7%	44.5%	48.2%	38.5%	38.5%	42.4%	38.5%	38.5%	38.5%	38.5%	38.5%
Minority/Operating profit			60.1%	65.8%	67.8%	59.8%	60.0%	58.3%	57.4%	58.8%	48.2%	47.9%	47.4%	48.6%	48.0%
Adjusted EBITDA	\$20,602	\$30,018	\$17,868	\$17,309	\$22,005	\$5,471	\$5,531	\$7,083	\$8,524	\$26,609	\$7,951	\$8,710	\$9,560	\$9,100	\$35,321
Cash Flow/Share	\$0.24	\$0.31	\$0.44	\$0.49	\$0.76	\$0.11	\$0.10	\$0.11	\$0.15	\$0.47	\$0.14	\$0.14	\$0.15	\$0.15	\$0.59
EBITDA/Share	\$0.41	\$0.53	\$0.34	\$0.43	\$0.47	\$0.15	\$0.15	\$0.17	\$0.20	\$0.68	\$0.18	\$0.20	\$0.22	\$0.21	\$0.80

**Quarterly Earnings Comparisons**

	Balance Sheets		Revenues (in \$000s)					Earnings per Share (non-GAAP)						
	12/31/09	3/31/10	March	June	Sept	Decem	Total	2005	2006	2007	2008	2009	2010E	
<b>Assets:</b>														
Cash and equivalents	8,412	5,618	2005	34,943	37,821	41,339	38,164	43,882						
Accounts receivable	32,580	31,216	2006	37,106	36,474	35,863	33,448	87,192						
Inventory	12,498	11,216	2007	32,751	35,563	35,955	36,149	140,418						
Prepaid expenses & other	4,513	6,116	2008	33,954	42,580	44,771	44,637	165,942						
Total current	58,003	54,166	2009	43,612	44,156	47,283	50,279	185,330						
Property & equip., net	32,881	31,274	2010E	48,389	50,300	52,300	54,300	205,289						
Goodwill & Intangibles	152,275	151,392												
Other	5,960	5,478												
<b>TOTAL ASSETS</b>	<b>249,119</b>	<b>242,310</b>												
<b>Liabilities:</b>														
Accounts payable	4,679	3,406	2005	0.04	0.07	0.09	0.06	0.28						
Accrued expenses	13,130	11,078	2006	0.04	0.04	0.88	(0.71)	0.25						
Current portion of LTD	2,556	1,931	2007	(0.00)	0.01	0.02	(0.44)	(0.41)						
Other	0	0	2008	0.01	0.02	0.04	(3.64)	(3.58)						
Total current	20,365	16,415	2009	0.03	0.03	0.05	0.06	0.16						
Long-term debt	45,963	42,895	2010E	0.06	0.06	0.07	0.07	0.25						
Deferred taxes & other long-term	9,375	8,368												
Minority interest	43,026	41,498												
Stockholders' equity	130,390	133,134												
<b>TOTAL LIAB &amp; EQ</b>	<b>249,119</b>	<b>242,310</b>												

Operating Statistics	2006	2007	2008	2009	2010E
<b>Installed units</b>					
Lithotripters-operated	100	110	120	130	130
Lithotripters -under maintenance	30	100	140	150	155
RevoLix Lasers	25	55	55	55	56
Active Partnerships	85	90	92	90	92
Annual Procedures	51,000	70,000	75,000	77,500	80,000
Radiation Oncology (IGRT)			1	2	3
Pathology lab locations		1	4	4	3

**Important Disclosures:**

**Price Chart:**



Price target and ratings changes over the past 3 years:

Initiated - September 18, 2009 – Target \$3.75  
 Downgraded – May 20, 2010 - Neutral

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Ratings Distribution	Company Coverage		Investment Banking	
	# of Companies	% of Total	# of Companies	% of Totals
Buy	10	71%	5	50%
Neutral	4	29%	3	75%
Sell	0	0%	0	0%
Total	14	100%	8	57%

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

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