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INSTITUTIONAL RESEARCH

Healthcare & Biotechnology

UPDATE REPORT

SIRONA DENTAL SYSTEMS (SIRO)

Strong “Cash” Earnings Justify Purchase of Shares

BUY

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Current Price \$28.41 Target Price \$44.00

Investment Highlights:

- 1) **With the shares of Sirona selling at only 13.5X our “cash” EPS estimate of \$2.08 for fiscal 2008 (SEP) we believe the stock is attractive for purchase.**
- 2) **With the full assimilation of Schick Technologies, Sirona cements its industry leadership as a world-wide, premier manufacturer of dental equipment.** Sirona offers a full suite of products to the dentist and dental lab including digital radiography; CAD/CAM systems for dental restoration; treatment workstations and dental instruments.
- 3) **Large, Underserved Market:** We estimate the potential market opportunity for SIRO’s product suite is approximately \$2.0 billion in North America., growing at about 10% per year. The world-wide opportunity is at least 2x that of North America and is growing at least as fast as N.A. and perhaps even faster depending on each specific market.
- 4) **Sirona Enjoys Strong Geographic Diversity and an Investment Hedge Against a Weak US Dollar.** Two-thirds of Sirona’s revenues are from markets outside the US and the company is experiencing very strong growth in Asia.
- 5) **Near-term Catalyst:** Sirona continues to enjoy very strong shipments of its industry leading CAD/CAM systems with very little competition.

Stock Data

52-Week Range	\$23.91-\$39.90	
Shares Outstanding (Mill)	55.18	
Market Capitalization (\$Bill)	\$1.54	
Average Daily Volume	383,458	
Book Value/Share	\$12.74	
Price/Book	2.2x	
Cash / Securities (\$Mill)	\$110.95	
Cash/Share	\$2.05	
Insider Ownership	69.2%	
Institutional Ownership	33.0%	
Debt (\$Mill)	\$591	
Dividend/Yield	N/A	
Short Interest (\$Mill) / %	\$121 / 7.4%	

<u>Estimates (Sep 30)</u>	<u>2007</u>	<u>2008E</u>
Sales	\$659.9	\$745.0
Adj. EPS	\$1.20	\$2.08
Net Inc. (Loss) (\$Mill)	\$56.5	\$53.7

Management

Chairman, CEO & Pres	Jost Fischer
EVP & CFO	Simone Blank
EVP & COO-U.S.	Jeffrey Slovin



Price target and ratings changes over the past 3 years:
Initiated December 20, 2006 – Hold – Price Target \$44.00
Upgraded January 11, 2007-Buy-Price Target \$44.00

See last page for important disclosures and analyst certification.

Recent Results

- **Sirona Dental increased revenue guidance for FY 2008 (Sep.) which calls for revenues to grow 10% to 13% to between \$725 million and \$745 million, up from its previous guidance of \$705 million and \$725 million. However, it did not increase its operating income guidance, which including amortization is forecast to increase 9% to 16% to a range of \$145 million to \$155 million.**
- The company reported its FY Q2 revenues of \$185.5 million exceeding street expectations of \$172 million. Reported GAAP EPS of \$0.20 would have been approximately \$0.34 with the exclusion of non-cash amortization expense and fell slightly short of the First Call consensus of \$0.37, a soft estimate given the variability of the non-cash expenses.
- Second quarter **revenue strength, up 26.2% Y/Y (+15.4% in constant currency)** continues to benefit from strong growth **non-U.S. markets where the increase was 36% (+19.0% in constant currency)**. Non-U.S. markets account for approximately two thirds of the company's overall revenues. **U.S. revenues advanced only 7% driven largely by CAD/CAM. US Imaging sales declined on a year-over-year basis but were also up against a very strong comparison a year ago driven by a customer loyalty program in the year ago quarter. On a world wide basis imaging sales were up 14% following a 16% increase in the first quarter as the GAILEOS 3-D system continues to take hold in international markets.**

Sirona Revenue Growth FY Q2 2008

	Reported	Constant Currency
CAD/CAM	40%	32%
Imaging Systems	14%	6%
Instruments	14%	1%
Treatment Centers	34%	17%
US	7%	
OUS	36%	19%

Source: Company Report

- It appears that there is substantial momentum in the international sales of the company's CAD/CAM businesses after a strong gain in the previous quarter (18% reported and 11% constant currency). While sales were strong in Germany and other European markets, all up double digits, the developing markets for the company of Australia, Canada and S. Korea were up very strongly as the company continues to increase its local sales representation in these countries. In the U.S. with respect to CAD/CAM, it appears that the trade-in program offered by Patterson Dental, the company's distributor, aimed at encouraging an upgrade from the compact milling machine to the MC XL is now complete and the mix of systems is moving toward two-thirds compact and one-third MC XL as management had originally anticipated. Dentist do not appear to be holding back from the trend to chair-side restoration and the broader market launch of the E4D by D4D Technologies LLC does not appear to be hurting SIRO competitively. In fact, management believes that competition will increase awareness and expand the market. Sirona continues to advance its system with upgrades such as the MC XL which produces a restoration in approximately four minutes. Last quarter, Sirona announced CEREC Connect, a web based communication platform that allows dentists to transmit digital impressions from the office to a laboratory. This will greatly aid dentists in performing multiple restorations for the

same patient. In addition, its Biogeneric Software significantly reduces the learning curve for dentists and is a key selling point for dentists that have not yet purchase a CAD/CAM system.

- Treatment Center revenues were up a surprising 34% with strong growth from all geographic regions. This compares to only a 10% increase in the previous quarter which faced a difficult comparison due to the advanced purchases of these products a year ago in recognition of an increase in the VAT in Germany implemented in January of 2007.
- Instruments also faced a particularly difficult comparison in the quarter due to the same situation with the German VAT tax but were up 14% on a reported basis.
- Sirona reported **GAAP EPS of \$0.20 on a fully diluted basis vs. a \$0.01** in the same period of last year. Excluding non-cash expenses including amortization, depreciation but including interest expense and taxing the result at a normalized 30%, **we estimate that “cash” EPS were \$0.48 vs. \$0.23** in Q2 FY 07. Assuming management’s guidance on revenues, annualizing the first half’s amortization expense, depreciation and a 30% tax rate, **“cash” EPS for fiscal 2008 could be as high as \$2.08. We estimate that reported GAAP EPS will be approximately \$0.97.**
- The **second half comparison will look somewhat odd because the company booked** a large tax benefit in the final quarter of fiscal 2007. Adjusting for that, excluding non-cash expenses including amortization, depreciation, but including interest expense and taxing the result at a normalized 35%, we estimate that “cash” EPS were \$0.42 in the final quarter of fiscal 2007. We estimate this will compare against \$0.53 in the final quarter of this year. In the current quarter, we estimate similar “cash” EPS of \$0.49 vs. \$0.27.

In our opinion, Sirona, with the assimilation of Schick, represents one of the largest, most innovative dental equipment companies in the world. While the U.S. dental market appears softer than we would like, the international business is strong and should provide a good balance over the next several quarters, particularly if the U.S. economy weakens further. Given the strong “cash” earnings power of Sirona and the shares selling at approximately 13.5x our “cash” estimate for fiscal 2008, we believe the current price provides an attractive entry point for owning or increasing positions in Sirona’s shares and we continue to recommend them with a BUY recommendation and a \$44.00 price target.

RISKS

We believe a Buy position with Sirona involves the following risks:

- **Clinical Indications** – Sirona continues to explore technology upgrades and additional indications for use of its current technologies including imaging and CAD/CAM. Its inability to discover and commercialize new applications and product improvements could relegate imaging and CAD/CAM to low double digit revenue growth contributors. While Sirona has a competitive product line with many innovative devices, the dental equipment market is highly competitive and the requirement for innovation and new clinical indications is enormous. A set-back or delay in such an initiative would negatively impact the company.
- **Regulatory** – Sirona relies on some of its products receiving approval from the Food and Drug Administration. The company currently has several products under development that must go through the approval process prior to commercial availability. Any delay will

negatively impact the company.

- **Capital Structure & Dilution-** Sirona had net debt of \$591 million at the end of fiscal Q2 2008. Its debt/equity ratio is 0.85 making it among the most leveraged medical device companies in the industry. With more than 75% of the shares held by MDP and its partners, we would expect a secondary offering which might include shares sold by the company to reduce its debt and leverage. This could lead to some dilution on the part of current shareholders.
- **Reimbursement** – Since there is only minimal reimbursement from government, private insurance and self-pay are the normal forms of reimbursement. Dramatic changes in the economy could have a significant effect on people’s ability to pay for dental services.
- **Competition** – The dental equipment device industry is highly competitive, from both private and public companies.
- **Sector Rotation** – Sirona is a medical device company and is often held in a portfolio with other device companies. A material event affecting one company many times affects the entire group.

Sirona Dental Systems, Inc.
 WORLDWIDE REVENUES BY SEGMENT
 (\$ millions)

REVENUE	2007A					2008E				
	Dec-06	Mar-07	Jun-07	Sep-07	Year	Dec-07	Mar-08	Jun-08	Sep-08	Year
Dental CAD/CAM Systems	\$ 52.5	\$ 47.2	\$ 51.5	\$ 57.3	\$ 208.5	\$ 61.97	\$ 66.21	\$ 59.18	\$ 60.20	\$ 247.55
Imaging Systems	58.9	52.9	54.5	59.5	225.7	68.0	60.3	60.0	59.5	247.7
Treatment Centers	40.6	29.4	31.0	42.0	143.0	44.5	39.3	34.1	42.0	160.0
Instruments	\$ 22.9	\$ 20.7	\$ 20.0	\$ 19.1	\$ 82.7	\$ 25.6	\$ 23.7	21.8	19.1	\$ 90.2
Total	\$ 174.8	\$ 150.2	\$ 157.0	\$ 177.9	\$ 659.9	\$ 200.1	\$ 189.5	\$ 175.1	\$ 180.8	\$ 745.5
PERCENT CHANGE Y/Y										
Dental CAD/CAM Systems	(10.6%)	(10.6%)	34.4%	68.4%	13.4%	18.1%	40.3%	15.0%	5.0%	18.8%
Imaging Systems	98.8%	92.2%	89.3%	27.0%	70.1%	15.6%	14.0%	10.0%	0.0%	9.8%
Treatment Centers	38.0%	(12.5%)	5.4%	11.6%	9.9%	9.8%	33.7%	10.0%	0.0%	11.9%
Instruments	38.2%	5.6%	7.0%	12.4%	15.1%	11.7%	14.4%	9.0%	0.0%	9.0%
Total	30.2%	12.5%	36.3%	31.3%	27.3%	14.5%	26.2%	11.5%	1.6%	13.0%

Source: Company and Dawson James Securities, Inc. estimates

Sirona Dental Systems, Inc.
Fiscal year ends September 30th
QUARTERLY EARNINGS MODEL, FY2007E-2008E
(\$ millions, except per share)

Fiscal year ends September 30th	Dec-06 Q1	Mar-07 Q2	Jun-07 Q3	Sep-07 Q4	2007	Dec-07 Q1	Mar-08 Q2A	Jun-08 Q3	Sep-08 Q4	2008E
Total revenue	\$ 174.8	\$ 150.2	\$ 157.0	\$ 177.9	\$ 659.9	\$ 200.1	\$ 189.5	\$ 175.1	\$ 180.8	\$ 745.5
Product costs	90.7	79.6	89.9	95.2	355.5	105.7	103.1	94.6	96.7	400.1
Gross profit	84.1	70.5	67.1	82.7	304.5	94.4	86.4	80.5	84.1	345.4
OPERATING EXPENSES										
S G & A	47.5	52.9	49.6	53.6	203.6	55.9	60.6	56.0	57.9	230.4
R & D	10.3	12.1	11.8	12.8	46.9	13.7	12.0	10.5	9.0	45.2
Doubtful Accounts & Notes	0.3	(0.1)	0.1	(0.1)		0.1	0.1			0.2
Net Other Op (inc.)/loss	(0.2)	0.1	0.1	(0.3)		(2.5)	(2.5)	(2.5)	(2.5)	(10.0)
Total operating expenses	57.9	65.0	61.7	66.0	250.6	67.1	70.2	64.0	64.4	265.8
Operating Income	26.1	5.6	5.5	16.7	53.9	27.2	16.2	16.5	19.7	79.6
Currency Transactions (gain)-net	(7.1)	(1.9)	(0.9)	(7.0)	(9.7)	(5.9)	(9.0)	(9.0)	(9.0)	(27.1)
Loss on Derivative Instruments	(0.5)	0.9	(2.6)	2.4	0.7	2.2	3.0	3.0	3.0	9.0
Interest Expense (Inc.)	9.0	6.2	5.8	7.2	19.2	6.7	6.7	6.7	6.7	20.0
Loss on Debt Extinguishment	21.1				-					-
Other Expenses				(0.6)	(0.6)		0.3	0.3	0.3	0.9
Total Non-Operating Expenses	22.5	5.2	2.3	2.0	9.6	3.1	0.9	0.9	0.9	2.7
EBT	3.6	0.3	3.2	14.6	21.8	24.1	15.3	16.8	20.0	76.2
Income tax provision	1.2	0.1	1.1	(37.4)	(34.9)	7.2	4.6	5.0	6.0	22.9
Minority interest	0.0	(0.1)	0.1	0.2	0.2	(0.1)	(0.2)			
Net income	\$2.3	\$0.3	\$2.0	\$51.8	56.5	\$17.0	\$10.9	\$11.8	\$14.0	53.7
Weighted ave. shares (diluted)	54.85	54.89	54.88	55.52	55.04	55.44	55.19	55.19	55.19	55.25
GAAP EPS Reported (FD)	\$0.04	\$0.01	\$0.04	\$0.93	\$1.02	\$0.31	\$0.20	\$0.21	\$0.25	\$0.97
EPS (FD) excl. Deal Related Dep, & Amort.	\$0.28	\$0.23	\$0.27	\$1.16	\$1.94	\$0.58	\$0.48	\$0.49	\$0.53	\$2.08
EPS (FD) excl. revaluation of exclusivity fee and revaluation of intra-group loans	\$0.43	\$0.21	\$0.24	\$0.24	\$1.12	\$0.36	\$0.34	\$0.35	\$0.41	\$1.46
RATIOS: AS A PERCENTAGE OF TOTAL REVENUE										
Gross margins	48.1%	47.0%	42.8%	46.5%	46.1%	47.2%	45.6%	46.0%	46.5%	46.3%
S G & A	27.2%	35.2%	31.6%	30.1%	30.9%	27.9%	32.0%	32.0%	32.0%	30.9%
R&D	5.9%	8.0%	7.5%	7.2%	7.1%	6.9%	6.3%	6.0%	5.0%	6.1%
Tax Rate	34.8%	37.7%	35.0%	34.0%	-160.2%	30.0%	30.0%	30.0%	30.0%	30.0%
Operating margin	15.0%	3.7%	3.5%	9.4%	8.2%	13.6%	8.5%	9.4%	10.9%	10.7%
Pretax margin	2.1%	0.2%	2.0%	8.2%	3.3%	12.1%	8.1%	9.6%	11.1%	10.2%
Net margin	1.3%	0.2%	1.3%	29.1%	8.6%	8.5%	5.8%	6.7%	7.7%	7.2%

NM = Not meaningful.

Source: Company and Dawson James Securities, Inc. estimates

DISCLOSURES



Initiated December 20, 2006 – Neutral – Price Target \$44.00
 Upgraded January 11, 2007-Buy-Price Target \$44.00

Analyst Certification: The analyst(s) whose name appears on this research report certifies that 1) all of the views expressed in this report accurately reflect his personal views about any and all of the subject securities or issuers discussed; and 2) no part of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst in this research report; and 3) All Dawson James employees, including the analyst(s) responsible for preparing this research report, may be eligible to receive non-product or service specific monetary bonus compensation that is based upon various factors, including total revenues of Dawson James and its affiliates as well as a portion of the proceeds from a broad pool of investment vehicles consisting of components of the compensation generated by investment banking activities, including but not limited to shares of stock and/or warrants, which may or may not include the securities referenced in this report.

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Ratings Distribution	Company Coverage		Investment Banking	
	# of Companies	% of Total	# of Companies	% of Totals
Speculative Buy	7	30%	4	57%
Strong Buy	3	13%	1	33%
Buy	11	48%	1	9%
Neutral	2	9%	1	50%
Sell	0	0%	0	0%
Sell Short	0	0%	0	0%
Under Review	0	0%	0	0%
Restricted	0	0%	0	0%
Total	23	100%	7	30%

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

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