

Mossberg's Investor Digest

Best Idea Profile

TomoTherapy Incorporated (Nasdaq: TOMO)

DESCRIPTION:

Headquartered in Madison, Wisconsin, 12-year-old TomoTherapy manufactures and sells radiation therapy systems for the treatment of cancer. TOMO's Hi Art systems have a unique technology that allows radiation to be targeted to cancerous tissue and limits exposure to healthy tissue. In addition to allowing for better patient outcomes, TOMO's technology significantly improves the speed of the treatment (up to 66% faster). Faster treatments mean clinics can treat more patients and drive better asset utilization. As of Dec 2008, TOMO had an installed base of 230 Hi Art systems, which represents roughly 3% of the 7,500+ radiation therapy systems installed globally (2006-Global Industry Analyst). TOMO sells to cancer treatment centers and hospitals in North America (64% of YTD sales), Europe, the Middle East, and Asia (17%).

KEY INVESTMENT CONSIDERATIONS:

Positive factors that could lead to resumed revenue growth – Due to a number of factors, including customer's difficulty in obtaining financing, systems revenue decreased 18% during 2008 and 23% during the first 9 mos of 2009. However, the following factors may allow TOMO to resume growth during 2010.

• **Reimbursement rates should remain stable for the next several years** - After being threatened with a nearly 50% reimbursement reduction, on Oct 30 Medicare and Medicaid set reimbursement rates for free standing oncology centers. The new rate schedule is expected to have a modest 5% reduction in rates over a period of the next 4 years (just over 1% per year). Order activity should benefit from the removal of the uncertainty surrounding a severe rate cut. Hospital reimbursement rates are up slightly.

• **New product offerings broaden addressable market** – The company recently launched two new radiotherapy products 1)TomoMobile – As its name implies, the mobile product is housed inside the back of a trailer and can be temporarily located outside a facility and moved from clinic to clinic. The mobile product will allow facilities to build new, and/or upgrade existing equipment, while continuing to provide treatments to patients. 2)TomoHD will be available during the second half of 2010. In addition to treating complex cancer cases, TomoHD will also treat relatively simple cases. This dual modality will lower the clinics operation costs and allow TOMO to address clinics that only have one radiotherapy machine. This is a new market for TOMO that represents over 51% of the overall market.

Recurring service revenue is becoming higher portion of the mix – As of the end of fiscal 2008, 99% of customers have entered into service contract with TOMO. As a percentage of mix, service revenue has grown from 17% to 28% of revenue, which should provide greater predictability and visibility into earnings. In addition to growing as a % of revenue, TOMO is focused on increasing profitability of service revenue, which is currently generating losses. In order to achieve industry standard gross margin of 35% to 40% (3Q margin was 14%), TOMO needs to roughly double the size of its installed base (in order to leverage fixed service delivery costs). Recent measures to improve service profitability include rationalizing the service and support organization with a 10% reduction in workforce, and product improvements, such as remote monitoring capabilities, which reduce high-cost touch labor.

VALUATION:

Revenue growth has a good chance of resuming during 2010, which would help restore profitability and drive a more reasonable valuation. The current valuation of 1x sales is a far cry from the 4x to 6x revenue TOMO commanded during 2007. TOMO has a considerable cash balance (\$147 million), which should provide some downside support for the stock and gives it several years to weather a downturn in equipment orders, restore growth, and improve profitability of its operations. In addition, as TOMO's technology gains traction as a standard device, it could become an acquisition target for a larger medical device company.

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Investment Data (as of 11/27/09)

Recent Price	\$3.16
52-Week Range	1.81 - 4.67
Fiscal Year End	December
Shares Outstanding	54 MM
Average Trading Volume (3 mos)	250,000
Market Capitalization	171MM
Cash	147 MM
Long Term Debt	N/A
Enterprise Value (EV)	24 MM
LT Debt/ Equity	N/A
BV/ Share	3.61
TTM Revenue	192 MM
P/ Revenue	0.9x
TTM EPS	-0.82
P/ EPS	N/A
TTM EBITDA	-23 MM
EV/ EBITDA	N/A

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