

Digirad Corporation

NasdaqGM: DRAD

Analyst: Etienne Lehideux

Sector: Healthcare

BUY

Target Price: \$6.3

Key Statistics as of 4/4/2015

Market Price:	\$4.52
Industry:	Medical Appliances & Equipment
Market Cap:	\$7,340 M
52-Week Range:	\$3.03 - 5.84
Beta:	0.5

Thesis Points:

- Broad product portfolio
- Solid strategy execution based on acquisition and product diversification
- Bullish guidance from management

Company Description:

Digirad Corporation provides diagnostic solutions in the United States. The company operates in two segments, Diagnostic Services and Diagnostic Imaging. The Diagnostic Services segment provides in-office nuclear cardiology and ultrasound imaging, and cardiac event monitoring services to physicians who perform nuclear imaging, echocardiography, vascular or general ultrasound tests, or any combination of these procedures in their offices, hospitals, and imaging centers. The Diagnostic Imaging segment sells medical diagnostic imaging systems, including solid-state gamma cameras for nuclear cardiology and general nuclear medicine applications, as well as provides camera maintenance services to physician offices, hospitals, imaging centers, and mobile service providers. The company was founded in 1985 and is headquartered in Suwanee, Georgia.

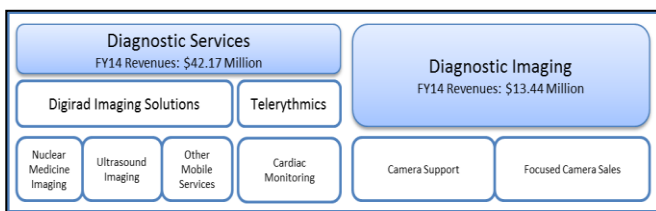


Thesis

Digirad Corporation provides diagnostic solutions to physicians and hospitals in the United States. It has a diversified portfolio of products and services that includes full-suite tailored imaging solutions, cardiac monitoring services, solid-state nuclear cameras sales, and after sale support. Digirad Corporation has a solid growth strategy through product diversification and a track record of well-executed acquisitions. As of December 31, 2014, Digirad had almost \$22 million in cash and was debt free. The company also pays a quarterly dividend of 5 cents per share, which is unusual for low priced stocks.

Products and Segments

Digirad Corporation is divided into two businesses: Diagnostic Services, which represents around 70% of their revenues, and Diagnostic Imaging, which represents the remaining 30%.



Diagnostic Services is split into two parts: Digirad Imaging Solutions and Telerythmics.

Digirad Imaging Solutions (DIS) provides licensed staffing and imaging equipment to physicians. It offers a convenient and economically efficient imaging services program as an alternative to purchasing a gamma camera or ultrasound equipment, or as an alternative to outsourcing the procedures to another physician or imaging center. For physicians who wish to perform nuclear imaging, echocardiography, vascular or general ultrasound tests, or any combination of these procedures in their offices, DIS provides the ability for them to engage these services, which include the use of Digirad's imaging system, qualified personnel, and related items required to perform imaging in the their own offices and bill Medicare, Medicaid, or one of the third-party healthcare insurers directly for those services. Diagnostic Services segment's services are also used by large and small hospitals, multi-practice physician groups, and imaging centers.

Digirad Corporation acquired Telerythmics in March

2014 and added the business to their DIS portfolio. Telerythmics is a 24-hour cardiac event monitoring service that is utilized on an outsourced basis by hospitals and physician offices. The company uses owned as well as per-use leased equipment to provide monitoring services for individual that have constant or periodic cardiac events. The patients are referred by hospitals, doctor offices and other medical care facilities. The acquisition allows Digirad to cross sell its services, since the two companies have a similar customer base, although not overlapping. One of Telerythmics' competitive advantages is that the company is staffed with critical care trained registered nurses, while competitors are staffed with technicians. Moreover, the company considers itself "device agnostic", which means that they use devices that met customers' needs regardless of the manufacturer.

The Diagnostic Imaging segment's revenue is derived primarily from selling solid-state gamma cameras and post-warranty camera support contracts. Digirad sells their imaging systems to physician offices, hospitals, and imaging centers primarily in the United States. Digirad has relationships and agreements with distributors around the world and aims to develop these relationships to the point where it can eventually grow its sales outside the United States. Digirad's camera offering consists of two main product lines, Cardius and Ergo:

The Cardius line offers dedicated cardiac solid-state imagers that are noted for their compactness, portability, and unique upright imaging capabilities that make it possible to image patients up to 500 pounds in a sitting position. Upright imaging makes it possible to image large bariatric, chronic obstructive pulmonary disease (COPD), or claustrophobic patients that typically could not be imaged lying down on competitive systems. The line offers fixed dual-head and triple-head cardiac camera models for dedicated use within a facility and portable configurations that make it possible to move the system to provide service to multiple rooms or sites.



The Ergo large-field-of-view imaging system is targeted to hospitals with multi-camera general nuclear medicine



departments, academic centers, pediatric hospitals, regional trauma centers, women's health centers, and cancer centers. Most general nuclear medicine departments have the need for a single-head planar portable camera for imaging patients

more conveniently on hospital stretchers, for imaging patients that cannot be moved, and for imaging patient's at their bedside (pediatrics, intensive care units, critical care units, emergency rooms, surgical suites, women's health clinics, or on regular patient floors). A single-head planar camera provides a more economical and convenient way to perform approximately 25% or more of all studies commonly performed in general nuclear medicine. It also opens the door to perform studies on critically ill patients in the patient's room and the ability to perform molecular breast imaging protocols that offer new revenue generation potential while improving the standard of patient care.

Finally, the Camera Support services include 20 field service engineers located throughout the U.S., who serve a significant installed base of cameras and have the ability to service non-Digirad models.

Competitive Advantages

Digirad Corporation delivers personalized healthcare services and technology focused on providing quality, flexibility, and cost efficiency in Nuclear Medicine, Nuclear Cardiology, Ultrasound Imaging, and Cardiac Event Monitoring on an "as needed, when needed, where needed basis".

For their imaging services and products, Digirad Corporation identifies several competitive strengths:

- *Broad portfolio of cardiovascular imaging services.* The company can offer multiple services such as nuclear cardiology imaging, echocardiography imaging, and vascular imaging services, which strengthens their

competitive position at each customer location.

- *Unique Dual Sales and Service Offering.* Digirad Corporation sells imaging systems to physicians who wish to perform nuclear imaging in their facilities and manage the related service logistics. The company offers both nuclear and ultrasound services in which they provide their systems and certified personnel to physicians on an annual basis in flexible increments, ranging from one day per month to several days per week without requiring them to make a capital investment, hire personnel, obtain licensure, or manage other logistics associated with operating a nuclear imaging site. Their ability to service their customers in a variety of capacities from selling the capital equipment directly at the point of need or being more flexible in a service-oriented model allows them to serve their customers exactly according to their needs.

- *Leading Solid-State Technology.* Digirad's solid-state gamma cameras utilize proprietary photo-detector modules that enable to build smaller and lighter cameras that are portable, with a degree of ruggedness that can withstand the vibration associated with transportation.

Their products allow portable application through reduced size and weight, and deliver a superior speed and image quality. They also offer improved patient comfort and utilization, which reduces patients' claustrophobia when comparing with traditional tube-based imaging systems.

Finally, Digirad has developed an intellectual property portfolio that includes product, component, and process patents covering various aspects of their imaging systems. The company has 38 issued U.S. patents and also licenses patents from third parties to enhance their product offering. In addition to the patent portfolio, Digirad Corporation has developed proprietary manufacturing, business know-how, and trade secrets.

The main risk associated with Digirad Corporation's business is that the company relies heavily on Medicare reimbursement to the company's customers. Since these reimbursements declined significantly in recent years, downward pressure on Digirad's prices can impact the revenue stream.

Strategy

Digirad's strategy is focused on driving income and cash flow from their business, with particular attention on

creating value for shareholders through earnings redistribution and punctual share repurchase.

Digirad Corporation's general strategy is to focus on three main areas for growth. First, the company engages in financially disciplined acquisitions, aligned with their mission statement: "being the market leader in delivering effective and efficient healthcare solutions on an as needed, when needed, and where needed basis." Second, the company seeks to add new services that they can add to their existing portfolio and deliver through their current distribution channels. Finally, the company works on organic growth, within their existing portfolios of services and channels.

On February 28, 2013, Digirad announced a plan to restructure the Diagnostic Imaging business to significantly reduce costs and focus on maximizing cash flow. This restructuring effort also included a reduction in force and was announced complete as of December 31, 2014.

Their acquisition of Telerythmics in March 2014 shows that the company's acquisition strategy is solid and their implementation effective. Indeed, the company managed to complete the integration in one year, as announced. Moreover, Telerythmics fits nicely in their Diagnostic Services business in two important ways. First, It is a solid, well-established and respected enterprise that has been doing business for more than 20 years. Second, it is a platform business with its call center and registered nurse that can support potential additional services.

In October 2014, Digirad Corporation approached health care commercialization company LDI, Inc with an open letter expressing their willingness to acquire the company. LDI, Inc turned down any negotiation, stating that the company was not for sale. The acquisition would be a solid strategic move for Digirad, allowing to turnaround a [business that has been destroying shareholders' value](#). Although LDI, Inc officially refused to meet with Digirad Incorporation's management, their shareholders may pressure the management to do so once they realize a merger would be beneficial to their interests.

In January 2015, Digirad Corporation entered in a planned strategic partnership in Perma-Fix Medical, a subsidiary of Perma-Fix. Under the agreement, [Digirad Corporation will invest \\$1 million](#) into Perma-Fix

Medical, which is traded on the Warsaw Stock Exchange, for approximately 5.4% of the outstanding common shares. When completed, Digirad will have the right to appoint one member to Perma-Fix Medical's Supervisory Board, and a second appointee to either the Supervisory Board or the management team. Digirad will assist Perma-Fix Medical in the development of and commercialization of Perma Fix Medical's proprietary process to produce Tc-99m without the use of uranium. Tc-99m is the most commonly used medical radioisotope for medical diagnostic procedures.

In march 2015, Digirad Corporation [acquired MD Office Solutions, Inc.](#), a mobile diagnostic imaging provider servicing customers in Northern California. After a short integration period, it is expected to be accretive on an EBITDA basis, producing over \$500,000 of EBITDA on an annual basis, assuming the same level of 2014 revenues of \$2.9 million.

Financials

FY 2014 results

Revenues were 55.6 million, representing a growth of 12.5% from 49.4 million in FY 2013. Diagnostic Services' revenues increased on a yearly basis by 13.4% to 42.2 million. Revenues from Diagnostic Imaging increased 9.8% to 13.4 million.

Gross Margins slightly improved to 29.92% from 28.59% in FY 2013, while EBITDA margins more than doubled to 9.61%. Gross margins for Diagnostic Services slightly decreased from 25.27% to 24.88% in FY 2014, while they significantly improved for Diagnostic Imaging, from 39.34% to 46.27%.

Operating Cash Flows were \$4.3 million versus \$2.2 and -\$1.1 in 2013 and 2012, respectively. The strong cash flow generation allows Digirad to accumulate reserves (\$22 million as of Dec. 31 2014) for future acquisitions and growth opportunities. It also permits to yield an annual 5% to shareholders with a \$0.05 quarterly dividend.

In Q4 2014 earning call, Digirad's CEO Matthew Molchan said he was very excited as the company moves forward in 2015, which he expects to be a record year in

profit. Fiscal 2015 guidance was between \$61 and \$63 million in revenues, representing a growth of up to 13.3% year over year.

Valuation

Based on a multiples valuation, Digirad appears undervalued. Indeed, 7/8 of the multiples used shows that Digirad trades at lower levels than its competitors.

	High	Low	Mean	Median	Digirad Corporation	Premium / Discount
TEV/Total Revenues LTM - Latest	32.3x	0.7x	8.1x	2.1x	1.2x	-43%
TEV/EBITDA LTM - Latest	161.8x	5.5x	35.5x	13.7x	12.4x	-9%
TEV/EBIT LTM - Latest	187.3x	8.2x	54.9x	28.4x	19.5x	-31%
P/Diluted EPS Before Extra LTM - Latest	207.9x	7.7x	52.4x	15.7x	34.8x	122%
P/TangBV LTM - Latest	21.5x	2.5x	8.7x	4.3x	2.9x	-33%
NTM TEV/Forward Total Revenue (Capital IQ)	19.86x	0.65x	7.97x	2.46x	1.09x	-56%
NTM TEV/Forward EBITDA (Capital IQ)	91.73x	5.12x	30.10x	13.67x	10.88x	-20%
NTM Forward P/E (Capital IQ)	95.66x	14.46x	55.06x	55.06x	20.55x	-63%

The average discount compared to peers' multiples is 17%. That is the minimum upside for this undiscovered, cash generating stock. Considering the strong growth prospects in the low end double digit range, the dividend yield, and the management's focus on creating shareholder value, this stock is set for solid appreciation in 2015.

