CER Report

CONM: NYSE AMEX | **Update** | **May 14, 2010**

Rating:	**Accumulate** (Unchanged)
Recent Price:	**$3.25** (5/13/10)
Price Target:	**$5.75** (Unchanged)

Conmed Healthcare Management, Inc.

Healthcare Services; Corrections

Conmed Healthcare Management is a provider of healthcare services at county and municipal correctional facilities in the continental U.S. The Company has contracts for fifty-three county sites in seven states, caring for over 18,000 detainees. Services include medical and behavioral healthcare for all inmates as well as record keeping and compliance functions. Conmed is headquartered in Hanover, Maryland and maintains an Internet presence at www.conmed-inc.com.

MARKET DATA

52-Week High/Low	$4.40 - $2.57
Ave. Daily Volume (6-mos.)	7 K
Shares Outstanding	12.6 M
Inside Ownership	25%
Institutional Ownership	50%
Float	9.4 mln
Short Interest (% of float)	<1%

FINANCIAL DATA

Market Capitalization	$41.0 M
- Cash & Equivalents	$11.7 M
+ Long-term Debt	$ -0- M
Enterprise Value	$29.3 M
Book Value	$15.9 M
Working Capital	$ 7.7 M
Dividend Yield	Nil

Balance sheet figures as of 3/31/10

	SALES	NET EARN	CFO	EPS
2008A	$40.6	($0.9)	$2.8	($0.08)
2009A	$52.8	($0.3)	$4.3	($0.00)
1Q10A	$14.8	$0.3		$0.02
2Q10E	*$16.4*	*$0.5*		*$0.04*
3Q10E	*$17.5*	*$0.7*		*$0.05*
4Q10E	*$18.5*	*$0.9*		*$0.07*
2010E	*$67.2*	*$2.4*	*$4.0*	*$0.18*
2011E	*$74.0*	*$3.1*	*$4.7*	*$0.23*

Dollars in millions, except EPS; Fiscal year ends Dec.

VALUATION

Price/Sales	0.8 X
Price/CFO	9.8 X
Price/Trailing 12-mo. Earnings	Neg
Price/Book Value	2.7 X
Consensus EPS Estimate 2010	NA
Consensus EPS Estimate 2011	NA

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HIGHLIGHTS

- **Quarter Performance.** In the March 2010 Conmed Healthcare Management reported $14.8 million in total revenue, providing $284,000 in net income or $0.02 per share. This compares to our estimate of $15.0 million in sales and $345,000 in net income or $0.03 per share.

- **Strong Execution.** Near flawless execution has given Conmed a nation-wide reputation as a reliable operator capable of delivering quality services. We believe it is only a matter of time before the Company achieves sufficient penetration of the market to have a national presence in the local detention center market.

- **Business Pipeline.** Opportunities valued near $125 million have apparently been narrowed down to a hit list of targets valued near $50 million. Management characterizes its approach as "measured" to maximize profitability and minimize business risks.

- **Rating and Price Target.** Although we made minor changes in our earnings model that trimmed a penny from our earnings estimate, we reiterate our accumulate recommendation and target price of $5.75.

PLEASE READ THE IMPORTANT DISCLOSURES AND DISCLAIMER ON PAGES 7 AND 8 OF THIS REPORT.

SUMMARY

Conmed management delivered sales and earnings results as promised in the first quarter 2010, demonstrating once again management's strong execution and consistency. Although we made minor changes in our earnings model that trimmed a penny from our earnings estimate, we reiterate our accumulate recommendation and target price of $5.75.

A promising business pipeline bodes well for top-line and earnings growth. Indeed, we believe it more likely than not that the Company could announce new contracts in the coming months that would be incremental to our current estimates. Since our valuation and target price are based on earnings, an upward adjustment would be the logical extension of upgraded estimates.

HIGHLIGHTS OF FIRST QUARTER 2010 RESULTS

In the March 2010 Conmed Healthcare Management reported $14.8 million in total revenue, providing $284,000 in net income or $0.02 per share. This compares to our estimate of $15.0 million in sales and $345,000 in net income or $0.03 per share. Our estimates did not include a charge for derivative liability that trimmed $43,000 from the bottom line. Excluding this charge we estimate reported net income would have been $327,000 or $0.02 per share.

Gross profit was 19.7% in the quarter, inching upward sequentially from 19.2% in the December quarter and declining compared to 21.5% in the year-ago quarter. Fluctuation in profit margin is due primarily to changes in medical expenses, which include hospitalization and emergency care. Such out-of-facility health care services are typically higher cost than procedures and treatments provided in the detention center facility. Out-of-facility care can vary materially quarter-to-quarter depending upon inmate populations and even a particular detainee in very poor health. The Company experienced unusually low out-of-facility expenses in the year-ago quarter.

Selling, general and administrative expenses totaled $2.0 million in the quarter, representing a spending rate of 13.5%. This compares to operational spending rates of 13.9% and 14.6% in the December 2009 and March 2009, respectively. The reduction in the operating expenses is due primarily to better coverage of fixed administrative costs on a higher revenue level. We believe the Company has executed well on cost controls even as administrative staff has been increased and business development strategies have been accelerated.

Operations generated $847,863 in cash, leaving the Company with $11.7 million in cash and equivalents at the end of the March quarter. Working capital increased to $7.7 million. The Company remains debt free.

EARNINGS MODEL

In addition to updating our model with first quarter 2010 results, we made modest adjustments to certain cost and spending assumptions. We also adjusted our assumptions for the effective tax rate and fully diluted shares outstanding. The net result of these changes is nominal. Our new sales estimate is $67.2 million (from $67.4 million), providing $2.4 million in net income or $0.18 per share (from $2.4 million and $0.19 per share). Our estimate for cash flow from operations is unchanged at $4.0 million.

The Company has been successful in renewing most of its contracts, including several of its largest relationships. Decisions on remaining renewals for the year are expected in the next two or three months. During the earnings conference call management indicated no problems are anticipated. Renewals have been successfully negotiated with cost of living adjustments, term extensions and some changes in scope of work. We believe the renewal record supports our current estimates.

During the earnings conference call management also provided the most detailed color on the Company's business pipeline that investors have heard in several quarters. Requests for proposals from local law enforcement jurisdictions have apparently increased compared to the same time last year. Furthermore, the Company's successful experience in managing larger facilities such as in Pima County, Arizona, has opened up the Company's addressable market to include facilities with higher inmate populations. Opportunities valued near $125 million have apparently been narrowed down to a hit list of targets valued near $50 million. Management characterizes its approach as "measured" to maximize profitability and minimize business and legal risks. At least two of the opportunities in the pipeline represent jurisdictions wherein the incumbent provider has lost favor and the contracting jurisdiction has sought out Conmed as a problem solver.

The Company continues to focus its efforts on key regions where Conmed already has operations. A new medical director was hired for the Pacific Coast Corridor in Oregon and Washington, fortifying the Company's capacity in the area. The Carolinas, Florida, certain Mid-Western states and the Mid-Atlantic region continue to be areas of high priority. Business development staff has apparently intensified promotional efforts, spending more time in face-to-face meetings with local law enforcement officials. Conmed's success in taking over medical and behavioral services at the Pima County Adult Detention Center has proved a strong reference customer for larger facilities.

Based on the Company's historical win rate on contracts, we believe it is more likely than not that Conmed can land at least one new contract before the end of 2010. Such an award would be incremental to our current estimates.

Results could also be impacted by an expansion into new markets. The Company is currently in discussion with the State of Maryland to provide mental health care services to the state prison system. The State of Maryland began circulating contractual requests near the beginning of March 2010. Conmed's behavioral health service has been a key differentiator for the Company since the acquisition of Comprehensive Mental Health Services in 2008. The fact that Conmed already provides medical and mental health services to the majority of counties in Maryland is a plus, since it would be possible for Conmed to provide near seamless care to from arrest through trial, sentencing and incarceration. The potential contract value is in a range of $14 million to $15 million annually, representing a potentially material increase in Conmed's top-line.

STOCK CHART

Source: Stockcharts.com

VALUATION AND OUTLOOK

Our target implies a multiple of 32 times our 2010 earnings estimate. This compares to our projected compound annual earnings growth rate near 35% over the next four years. In our view, the valuation is justified relative to the growth potential in Conmed's operations. Near flawless execution has given Conmed a nation-wide reputation as a reliable operator capable of delivering quality services. We believe it is only a matter of time before the Company achieves sufficient penetration of the market to have a national presence in the local detention center market.

Shares of Conmed continue to trade under low volume, which has protected the stock from some of the drag on valuation in the greater U.S. equity market such as global credit concerns. Unfortunately, CONM appears to be trapped in a narrow band between the $3.14 and $3.40 price levels corresponding to a level of price support we believe has been built over historic trading sessions. We believe a new contract win would be a sufficient catalyst to propel the stock out of this range. A line of price resistance may be present at the $3.75 price level. However, we believe this is a much weaker obstacle to upward price movement.

ADDITIONAL INFORMATION AVAILABLE UPON REQUEST

Table I: Historical and Projected Sales and Expenses

Dollars in Thousands	2008	1Q09	2Q09	3Q09	4Q09	2009	1Q10	*2Q10E*	*3Q10E*	*4Q10E*	*2010E*	*2011E*
Total revenue	40,550	12,419	12,713	13,643	14,009	52,784	14,752	*16,400*	*17,500*	*18,500*	*67,152*	*74,000*
Direct costs												
Salaries, wages & benefits	21,413	6,988	7,250	7,900	7,733	29,871	8,215	*9,102*	*9,538*	*10,083*	*36,937*	*40,700*
Medical expenses	10,378	2,382	2,382	2,485	3,036	10,285	3,140	*3,362*	*3,588*	*3,793*	*13,882*	*14,800*
Other operating expenses	1,334	384	480	525	551	1,940	495	*574*	*613*	*648*	*2,329*	*2,220*
Direct costs	33,125	9,754	10,112	10,910	11,320	42,096	11,850	*13,038*	*13,738*	*14,523*	*53,148*	*59,200*
Gross profit	7,425	2,665	2,601	2,733	2,689	10,688	2,902	*3,362*	*3,763*	*3,978*	*14,004*	*14,800*
Operating expenses:												
Selling, general & administrative	6,359	1,816	1,944	2,015	1,946	7,721	2,003	*2,050*	*2,100*	*2,128*	*8,281*	*8,510*
Depreciation & amortization	2,132	634	606	387	343	1,970	320	*425*	*325*	*125*	*1,195*	*321*
Total operating expenses	8,491	2,450	2,550	2,402	2,289	9,691	2,323	*2,475*	*2,425*	*2,253*	*9,476*	*8,831*
Operating income (loss)	(1,066)	215	51	331	400	997	579	*887*	*1,338*	*1,725*	*4,529*	*5,969*
Other income (expense)												
Interest income	154	28	16	17	19	80	18	*25*	*25*	*25*	*93*	*50*
Interest expense	(7)	(5)	(2)	(1)	-	(8)	-	-	-	-	-	-
Other, net	-	1	(2,445)	756	479	(1,209)	(43)	-	-	-	*(43)*	-
Total other income (expense)	148	24	(2,431)	772	498	(1,137)	(25)	*25*	*25*	*25*	*50*	*50*
Income (loss) before income taxes	(919)	239	(2,380)	1,103	898	(140)	554	*912*	*1,363*	*1,750*	*4,579*	*6,019*
Provision for income taxes (benefit from)	-	121	32	249	(515)	(113)	270	*438*	*654*	*840*	*2,202*	*2,889*
Net income (loss)	(919)	118	(2,412)	854	1,413	(27)	284	*474*	*709*	*910*	*2,377*	*3,130*
Net EPS (loss), available to shareholders	$ (0.08)	$ 0.01	$ (0.19)	$ 0.01	$ 0.07	$ (0.00)	$ 0.02	*$ 0.04*	*$ 0.05*	*$ 0.07*	*$ 0.18*	*$ 0.23*
Weighted shares outstanding, diluted	12,090	13,529	12,560	14,183	14,105	12,566	14,206	*13,250*	*13,250*	*13,250*	*13,250*	*13,500*

2007 results are shown pro forma *for the calendar year, reflecting a combination of reported results for the Conmed predecessor for January 1 through January 26, 2007 and the Conmed successor for January 27 through December 31, 2007.*

Source: Company Reports and Crystal Equity Research Estimates

Table II: Selected Measures of Historical and Projected Sales and Expenses

Dollars in Thousands	2008	1Q09	2Q09	3Q09	4Q09	2009	1Q10	2Q10E	3Q10E	4Q10E	2010E	2011E
Total revenue	40,550	12,419	12,713	13,643	14,009	52,784	14,752	16,400	17,500	18,500	67,152	74,000
Operating income (loss)	(1,066)	215	51	331	400	997	579	887	1,338	1,725	4,529	5,969
Net income (loss)	(919)	118	(2,412)	854	1,413	(27)	284	474	709	910	2,377	3,130
Net EPS (loss), available to shareholders	$ (0.08)	$ 0.01	$ (0.19)	$ 0.01	$ 0.07	$ (0.00)	$ 0.02	$ 0.04	$ 0.05	$ 0.07	$ 0.18	$ 0.23
Weighted shares outstanding, diluted	12,090	13,529	12,560	14,183	14,105	12,566	14,206	13,250	13,250	13,250	13,250	13,500
SELECTED MEASURES:												
Sales growth yr/yr	55.5%					30.2%					27.2%	10.2%
Net income yr/yr	45.0%					97.1%					8902.7%	31.7%
EPS growth, yr/yr	53.2%					97.2%					8448.3%	29.2%
Gross margin	18.3%	21.5%	20.5%	20.0%	19.2%	20.2%	19.7%	20.5%	21.5%	21.5%	20.9%	20.0%
Operating margin	-2.6%	1.7%	0.4%	2.4%	2.9%	1.9%	3.9%	5.4%	7.6%	9.3%	6.7%	8.1%
Net margin	-2.3%	1.0%	-19.0%	6.3%	10.1%	-0.1%	1.9%	2.9%	4.0%	4.9%	3.5%	4.2%
Direct costs, % sales	81.7%	78.5%	79.5%	80.0%	80.8%	79.8%	80.3%	79.5%	78.5%	78.5%	79.1%	80.0%
Salaries, wages & benefits	52.8%	56.3%	57.0%	57.9%	55.2%	56.6%	55.7%	55.5%	54.5%	54.5%	55.0%	55.0%
Medical expenses	25.6%	19.2%	18.7%	18.2%	21.7%	19.5%	21.3%	20.5%	20.5%	20.5%	20.7%	20.0%
Other direct operating expenses	3.3%	3.1%	3.8%	3.8%	3.9%	3.7%	3.4%	3.5%	3.5%	3.5%	3.5%	3.0%
G&A expense, % sales	15.7%	14.6%	15.3%	14.8%	13.9%	14.6%	13.6%	12.5%	12.0%	11.5%	12.3%	11.5%
Effective tax rate	0.0%	50.6%	-1.3%	22.6%	-57.3%	80.7%	48.7%	48.0%	48.0%	48.0%	48.1%	48.0%
EBITDA, $$	1,066					2,968					5,829	6,290
EBITDA margin	2.6%					5.6%					8.7%	8.5%

2007 results are shown pro forma *for the calendar year, reflecting a combination of reported results for the Conmed predecessor for January 1 through January 26, 2007 and the Conmed successor for January 27 through December 31, 2007.*

Source: Company Reports and Crystal Equity Research Estimates

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ANALYST

Debra Fiakas, CFA is a seasoned, credentialed investment professional with a diversified and successful track record as a research analyst and as an investment banker. Her decade-plus career includes solid experience in all aspects of the equity capital markets with particular emphasis on emerging growth companies operating in the technology sectors. Ms. Fiakas is also the principal member of Crystal Equity Research, LLC.

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CER REPORT RESEARCH UNIVERSE*

Speculative Buy	4	80%	Unproved business model; catalysts exist to generate higher returns
Accumulate	1	20%	Long-term return potential above 10%; near-term catalysts may not exist
Hold	0	0%	Total return potential below 10%; an acceptable long-term holding
Sell	0	0%	Potential return greater than negative 10%; take profits or stem losses
Not Rated	0	0%	No rating
Total	5	100%	

**Research universe categorized by rating only; Crystal Equity Research provides no investment banking services.*

HISTORICAL RECOMMENDATIONS AND TARGET PRICE: Conmed Healthcare Management

Report	Date	Price	Rating	Target Price
Initial	7/7/08	$1.70	Speculative Buy	$4.50
Update	7/25/08	$2.05	Speculative Buy	$5.00
Update	8/15/08	$2.50	Speculative Buy	$5.00
Update	11/14/08	$2.40	Speculative Buy	$5.00
Update	2/20/09	$2.10	Speculative Buy	$5.00
Update	3/27/09	$2.20	Speculative Buy	$5.00
Update	5/15/09	$3.00	Speculative Buy	$5.00
Update	6/22/09	$3.50	Speculative Buy	$5.25
Update	8/13/09	$3.73	Accumulate	$5.25
Update	11/13/09	$3.09	Accumulate	$5.25
Update	2/1/10	$3.16	Accumulate	$5.75
Update	3/26/10	$3.36	Accumulate	$5.75
Update	5/14/10	$3.25	Accumulate	$5.75

DISCLOSURES

Name	**Symbol: Exchange**	**Disclosures**
Conmed Healthcare Management, Inc.	CONM: NYSE AMEX	D

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