CER Report

CONM: NYSE AMEX **Update** **June 29, 2010**

Conmed Healthcare Management, Inc.

Healthcare Services; Corrections

Rating:	**Accumulate** (Unchanged)
Recent Price:	**$3.36** (6/28/10)
Price Target:	**$5.75** (Unchanged)

MARKET DATA

52-Week High/Low	$4.40 - $2.57
Ave. Daily Volume (6-mos.)	6 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	$42.3 M
- Cash & Equivalents	$11.7 M
+ Long-term Debt	$ -0- M
Enterprise Value	$30.6 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	10.3 X
Price/Trailing 12-mo. Earnings	33.6 X
Price/Book Value	2.7 X
Consensus EPS Estimate 2010	NA
Consensus EPS Estimate 2011	NA

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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-four county sites in seven states, caring for over 18,600 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.

HIGHLIGHTS

- **New Contract.** Conmed won a new contract with the City of Roanoke, VA valued at $9.1 million over the next five years or approximately $1.9 million in revenue per year. The three-year contract has two one-year renewal options.

- **Revenue Run Rate.** We estimate the Roanoke contract increases Conmed's annual revenue run rate to approximately $61.0 million. The contract will begin contributing to top-line at the beginning of 3Q10, adding approximately $900,000 in 2H10.

- **Earnings Model.** We are not changing our earnings estimates at this time, since we view the contract as at least partial fulfillment of the revenue growth we had anticipated in our earnings model.

- **Valuation.** We reiterate our Accumulate rating on CONM. Our price target of $5.75 implies a price earnings ratio of 31.9 times our 2010 EPS estimate of $0.18. More importantly it implies a multiple of 18.1 times our estimate of CFO in 2010.

- **Outlook.** We expect additional contract announcements to serve as catalysts for trading in the stock. Year-over-year comparisons of sales and earnings should remain positive for the balance of the year 2010.

PLEASE READ THE IMPORTANT DISCLOSURES AND DISCLAIMER ON PAGES 6 AND 7 OF THIS REPORT.

CONTRACT AWARD

Conmed Healthcare Management won a new contract with the City of Roanoke, Virginia valued at $9.1 million over the next five years or approximately $1.9 million in revenue per year. The three-year contract has two one-year renewal options. Beginning July 2010, the Company will provide healthcare services to approximately 600 detainees, including medical, dental, mental health services. As part of the overall service Conmed also provides pharmacy, laboratory and X-ray services and manages hospitalization and other out-of-facility services for the facility's inmates. The Roanoke contract calls for Conmed to institute an electronic medical record system. We expect success with this provision to serve as a strong reference in future prospecting.

The Roanoke Police Department is a Certified Crime Prevention Community and is nationally accredited through the Commission on Accreditation for Law Enforcement Agencies (CALEA). It serves the community of Roanoke which is located between the Blue Ridge and Virginia Allegheny Highlands in the middle of the State of Virginia and approximately 168 miles west of the state capital in Richmond, VA. The location affords a highly diversified population with over ninety different cultures and languages represented in the population near 100,000 people. The population is projected to be approximately 325,000 in 2020, a 12% to 13% change between 2000 and 2020. Such growth would ensure the community remains among the top ten communities in the Commonwealth of Virginia. In the 2000 census, the last period for which there is reliable data, the median income for a household in the city was $30,719, and the median income for a family was $37,826. Males had a median income of $28,465 versus $21,591 for females. The per capita income for the city was $18,468. About 12.9% of families and 15.9% of the population were below the poverty level, including 24.4% of those under age 18 and 11.3% of those 65 years and older.

NEW CONTRACT VALIDATES ESTIMATES

In our view, the Roanoke contract announcement validates our estimates for the second half of 2010. We estimate the Roanoke contract increases Conmed's annual revenue run rate to approximately $61.0 million. The contract will begin contributing to revenue and earnings at the beginning of the third quarter 2010, adding approximately $900,000 to the top-line. Although the Company does not provide details on the profit margins in individual contracts, we have assumed for the purposes of our earnings model that the profit margins on the Roanoke agreement will be similar to those on existing contracts. The Roanoke facility is near another Conmed contract location, the Western Virginia Regional Jail. Management anticipates the close proximity of the two facilities could lead to some operational efficiency.

We note that the Roanoke contract calls for the institution of electronic medical records. Electronic record keeping is often associated with higher costs. Nonetheless, we believe the ground work that the Company has already done with regard to electronic medical record keeping and the potential to use the experience in Roanoke across the entire Conmed platform, could ultimately lead to operating efficiencies.

We are not changing our earnings estimates at this time, since we view the contract as at least partial fulfillment of the revenue growth we had anticipated in our earnings model. Our model had reflected approximately $6.0 million incremental revenue over the prevailing revenue run rate.

We expect renewals of existing contracts with scheduled rate increases, contract expansions and detainee population increases could generate additional revenue growth. More importantly, the Company's business pipeline remains robust with additional opportunities for new relationships contributing material sales and earnings. For example, the Company's has bid on a contract with the State of Maryland Correctional Department to provide behavioral health services to the state prison population. The contract is valued at approximately $14.0 million per year. We expect Maryland to make an announcement in the near-term. Should the Company be awarded the contract, we believe it would trigger a revision of our estimates since the growth factor remaining in our 2010 estimate is now just over $5.0 million, well short of the possible contribution the Maryland relationship could provide should the contract begin within the third quarter 2010.

INSIDER OWNERSHIP UPDATE

The 2010 annual proxy statement provides some insight into leadership not otherwise reported in the Company's filings. Insiders hold 3.0 million shares of common stock and 1.2 million options exercisable by the beginning of July 2010. John Pappajohn, one of the Company's independent directors holds the majority with 2.5 million shares and 40,000 options. CEO Richard Turner owns the second largest insider position with 10,000 shares of common stock and 868,750 options. Insider holdings of common stock represent 23.8% of the total shares outstanding. Assuming exercise of all options, insiders would hold 30.4% of the then outstanding common shares.

There are three significant holders listed in the proxy, which together holding 4.6 million shares. One of the 5% owners also holds 91,570 warrants exercisable at $0.30 per share. Along with insider holdings and assuming these shares are infrequently trade, the implied constructive float is 5.0 million shares. As of the end of March 31, 2010 another 3.5 million shares were reported as held by institutions and mutual funds not otherwise included in the insider or 5% holder categories. We estimate another 500,000 shares may be held in hedge funds that do not publicly report portfolio positions.

We believe the closely held nature of Conmed's common stock may be one factor impacting trading volume in CONM. The despite a strong contract record, achievement of profitability and positive operating cash flow, and a strong balance sheet, average daily volume remains sluggish near 7,500 shares per day. That strength has earned the Company a loyal following of significant holders and professionally managed funds which may not trade the stock with any frequency. We estimate as few as 1.0 million shares may be held by individual investors.

VALUATION AND OUTLOOK

We reiterate our Accumulate rating on Conmed Healthcare Management and $5.75 price target. Our price target implies a price earnings ratio of 31.9 times our 2010 earnings estimate of $0.18. More importantly it implies a multiple of 18.1 times our estimate of cash flow from operations in 2010. In our view, the stock is undervalued against the Company's ability to grow earnings and generate cash flow. Shallow trading volume remains a critical factor in the price appreciation of CONM. We expect additional contract announcements to serves as catalysts for trading in the stock. Furthermore, year-over-year comparisons of sales and earnings should remain positive for the balance of the year 2010, building on contract awards in early 2010 as well as contract renewals that incorporated rate adjustments.

STOCK CHART

Source: Stockcharts.com

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.

ANALYST CERTIFICATION

The analyst who is primarily responsible for this research and whose name is listed first under Analysts above certifies that: 1) all of the views expressed in this research accurately reflect his or her professional views about any and all of the subject securities or issuers, and 2) no part of any of the analyst's compensation was, is or will be directly or indirectly related to the specific rating expressed by analyst in this research.

CER REPORT RESEARCH UNIVERSE*

Speculative Buy	3	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	4	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
Update	6/29/10	$3.36	Accumulate	$5.75

DISCLOSURES

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

Disclosure Key

A A member or employee of Crystal Equity Research, LLC serves on the board of directors of the company.
B A controlling member of Crystal Equity Research, LLC has a beneficial interest in the common stock of the company.
C A person or persons preparing this report or an immediate family member of the preparer has a beneficial interest in the common stock of the company.
D Crystal Equity Research, LLC received compensation for research coverage from the company or one of its agents. Subscription fees for CER Research Coverage are paid in advance in cash.
E The company has a convertible issue outstanding.
F The securities covered in this report can be optioned.
G The securities covered in this report can be margined.

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