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Update: Hologic, Inc.	(HOLX: \$23.75)	May 1, 2008
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Close position

Target: na

	2Q08a	3Q08e	4Q08e	1Q09e	FY2008e	FY2009e
Rev (\$Ms)	431.0	435.2	443.7	438.7	1,681.5	1,750.9
EPS (\$)	0.29	0.29	0.30	0.30	1.15	1.20
Y/Y Growth	33.7%	18.9%	-4.5%	12.9%	20.4%	4.1%
PE	na	na	na	na	20.7	19.8
PSR	na	na	na	na	3.7	3.5
Consensus	na	0.30	0.32	0.35	1.19	1.47

Shares Out: 260M

Market Cap: \$6.18B

FYE: Sept.

Summary: HOLX reported F2Q08 revenue of \$431.0M and adjusted EPS of \$0.29, excluding the amortization of intangibles related to its recent acquisitions. These results exceeded the "street's" estimates of \$418.2M in revenue and \$0.28 EPS.

Nevertheless, HOLX' results and the ensuing conference call were clearly disappointing to investors. Problems included lower than expected Novasure revenue, lower than expected diagnostic revenue (primarily the ThinPrep pap test), lower than expected gross margins, and cautionary comments on the conference call about increasing competition by GE and Siemens in digital mammography, and the resulting pricing pressures, sequentially flat new orders and a declining backlog for the Selenia. Importantly, 3Q08 and FY2008 guidance was lower than the "street's" estimates.

The biggest disappointment, and of great concern on the conference call, was HOLX' Novasure product for treating excessive menstrual bleeding. Novasure's 2Q08 revenue was \$55.2M, nearly 10% below the "street's" estimate of \$60.8M. It appears that management's effort to increase Novasure procedures in "office" settings was not enough to offset the weakness experienced in "hospital" settings during 2Q08. We predicted, in our initial report, that "the lack of sanitation and the lack of safety equipment (used when offering general anesthesia and to deal with emergencies related to reactions to sedatives) in an office setting are the two biggest reasons why Novasure is unlikely to make significant gains in doctor's offices."

New orders for Selenia units increased only slightly, from 373 in 1Q08 to 375 in 2Q08, essentially flat, and backlog fell from 578 units to 535, respectively. It is not clear to us, yet, whether this quarter reflects seasonality or if it is the beginning of a slowdown. Importantly, management noted that GE and Siemens are pricing their digital mammography systems more aggressively in the US, especially at key accounts. We expect Selenia ASPs to continue to decline year over year, as has been the case over the past 7 quarters, driven mainly by increasing competition, greater saturation of the market, and the fact that the remaining sales opportunities are primarily smaller, more price sensitive imaging centers, according to our industry sources.

Management's guidance for 3Q08 is \$435M in revenue and \$0.29 in EPS. This is below the "street's" \$443.7M and \$0.30 consensus estimates and is driven by continued weakness of Novasure. Its FY2008 revenue guidance is \$1.7B versus a \$1.69B consensus. FY2008 EPS guidance of \$1.15-\$1.18 is unchanged from a quarter ago, but is below the "street's" \$1.19 expectation.

Investors were disappointed by HOLX' results and guidance, and shares fell 19% in today's trading. We think that the company lost credibility in regards to the Cytoc acquisition, which was supposed to provide a stable recurring revenue stream but, instead, has led to some disappointment. Additionally, we think that investors had become accustomed to HOLX' conservative guidance in the past,

and expected management's EPS guidance and the "street's" EPS estimates to increase each quarter throughout the year. The realization that HOLX' FY2008 EPS may, in fact, be reported within management's range of \$1.15-1.19, and not above, is a disappointment.

Our thesis appears to be playing out. Selenia ASPs are in decline, competition in digital mammography is increasing, Selenia new orders may be slowing down, and the Cytyc businesses appear to be less robust than investors thought. We expect sales of Selenia to decline in FY2009 and forecast FY2009 EPS of \$1.20 versus the "street's" \$1.47 consensus. However, given that HOLX' valuation multiple has contracted, that investor sentiment has turned more negative, and that our FY2008 EPS estimate of \$1.15 is in line with management's guidance, we are closing our position. We initiated our Sell recommendation on 1/6/08 at a price of \$35.56. Since then, HOLX' shares have depreciated in value by 33.2%, which compares favorably to a 1.1% appreciation of the Russell 2000 Index over the same time period. We note that HOLX shares fell below our \$22 price target in intraday trading today and closed at \$23.75.

Discussion:

1. Breast Health revenue grew 35% y/y, adjusted for the Cytyc acquisition, to \$223.3M. This compares to the "street's" \$208.1M estimate.

The better than expected Breast Health revenues were driven primarily by the shipment of 418 Selenia in the quarter versus the "street's" expectation for 397. However, new orders for Selenia were roughly flat sequentially from 373 in 1Q08 to 375 in 2Q08 (4Q07 was 403). Selenia backlog was 535 systems, down from 589 and 578 at quarter-ends 4Q07 and 1Q08, respectively. It is not clear to us, yet, whether this trend reflects seasonality, or if it is the beginning of a slowdown.

2. Skeletal Health revenue of \$28.1M exceeded the "street" estimate of \$23.9M. The upside was driven primarily by increasing sales of mini C-arms.

3. Revenue for the company's Diagnostic segment, which is comprised mostly of ThinPrep pap test sales, was reported at \$124.4M versus the "street's" \$127.3M expectation. 8.8M ThinPrep pap tests were performed in the quarter, which is lower than the 9.0M per quarter "street" expectation.

4. HOLX' GYN Surgical (Novasure) segment reported revenue of \$55.2M. This was well below the "street's" \$60.8M estimate. In addition to the challenges of selling Novasure into an "office" setting, as we discussed in our initiation report, the soft economy may have negatively affected the demand for this "elective" procedure, according to management.

5. 2Q08 gross margins were reported at 62.0%, excluding a one-time inventory charge. This was slightly below the “street’s” 62.1% estimate and below management’s guidance of 62%-63%. It is difficult to know the primary cause for the disappointment given the lack of historical quarters for the combined Hologic/Cytoc entity.