

BY THE CALAMOS
INVESTMENT TEAM

Signs of Life in Health Care Technology

Companies within the health care sector are facing many changes that will provide challenges as well as opportunities. While there is much uncertainty surrounding the sector, it seems clear the demand for health care will grow and that the suppliers of health care will face increasing pressure to make their services and products more affordable. From an investing standpoint, we believe companies that can innovate or are low-cost providers of quality products will create the most shareholder value in this environment.

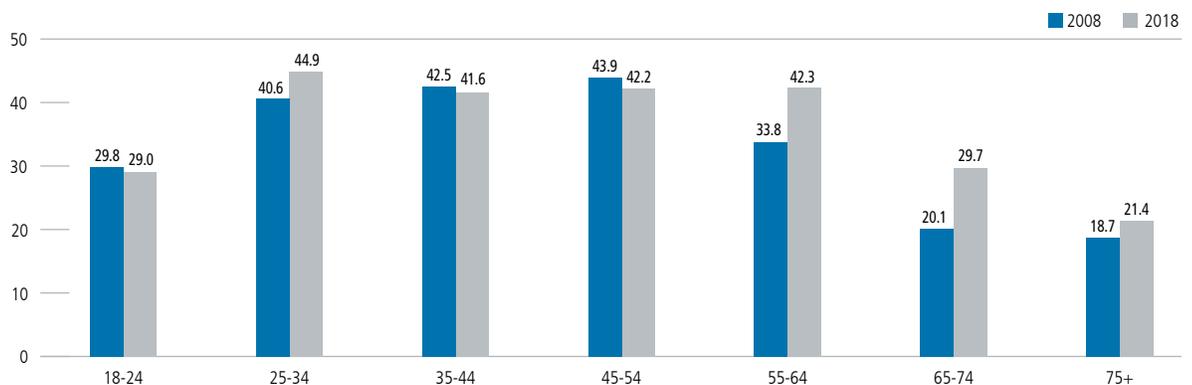
Increasing health care demand in developed nations will come in large part through a burgeoning senior population. The number of individuals entering the senior ranks will continue to grow over the coming decade (Figure 1) and their life expectancy is expected to increase. Within developing countries, growing populations and improved access to health care will stoke demand.

However, costs will be the primary focus for the payers of health care. Insurance companies will continue to resist rising payments. Governments are mindful of the growing expenditures to health care as budget deficits are increasingly

a concern. More government regulation and the persistent risk of adverse side effects from medical treatment may also have a negative impact on health care companies' net earnings and returns on capital. In essence, there is growing demand but potential for lower profitability.

In this environment, innovative companies that create high-demand products should enjoy pricing power, better returns on capital and, ultimately, rising equity values. On the other end of the spectrum, low-cost producers are best positioned to manage future pricing pressures and to enter the low-priced environment of emerging markets. Also, we

FIGURE 1. ESTIMATED U.S. POPULATION BY AGE 2008-2018 (IN MILLIONS)



Source: U.S. Census Bureau

With the boomer generation – 78 million people strong – turning 55 or older and living longer than past generations, there likely will be a 25% or more increase in the number of those aged 55 to 64 and nearly a 48% increase in those 65 to 74. Even the number of adults older than 75 is projected to increase by nearly 15% as a result of longer life spans.

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believe that for innovative companies and low-cost providers, technology will play a vital role. Demand for technology providers' products should be strong even if end-market pricing pressure persists.

In this environment, innovative companies that create high-demand products should enjoy pricing power, better returns on capital and, ultimately, rising equity values.

Within the health care technology industry, we are focusing on:

1. Companies that develop technology that enhances productivity—such as an electronic medical records management provider
2. Companies that develop technology that can be used for new product development—such as a gene sequencing equipment manufacturer
3. Companies that use technology to develop medical advancements—such as a biotechnology company

Each of these business strategies can provide their customers with innovation, the ability to lower costs, or both.

Identifying Opportunities in Health Care Technology

In broad strokes, our growth investing process involves:

1. Identifying the fastest growing companies
2. Reviewing the quality and sustainability of the company's growth, which includes:
 - > An assessment of management's ability to run a growth company
 - > Balance sheet strength to fund future growth
 - > Business model's return on capital potential
3. Assessing the return potential of the stock
4. Assessing the position's potential "fit" within the portfolio's top-down themes and the risk/reward

The following three examples were vetted through this process and, as of June 30, 2010, held by Calamos Growth investors. These companies represent each of the three technology areas discussed previously: productivity enhancer (Example 1), manufacturer of new product development technology (Example 2), and a user of technology to develop new treatment advances (Example 3).

Example 1: Productivity enhancer. This company manufactures a surgical system that translates a surgeon's hand movements on instrument controls into corresponding micro-movements of instruments positioned inside a patient. This surgical system is a major innovation for minimally invasive surgery (MIS), combining superior 3-D visualization with enhanced dexterity, precision and control in an intuitive, ergonomic interface. The cutting-edge technology behind the system is simplifying existing MIS procedures, making them quicker and easier. The system also makes previously difficult MIS operations routine and new MIS procedures possible. The enhanced surgical capabilities are producing better patient outcomes through faster healing times, lower risk of infection, and shorter hospital stays. This is the first robotic surgical system cleared by the FDA for general laparoscopic surgery and is also approved for use in several other procedures. More than 1,400 systems are installed in hospitals worldwide. The company has an expanding portfolio of research and development accomplishments with rights or licenses to more than 400 U.S. and non-U.S. patents.

We believe this firm is well positioned to benefit from the growing demand for less invasive surgical procedures. When new technology makes a procedure less invasive and improves efficacy, there is often a rapid adoption of that new technology. That is occurring with this company's surgical system for several procedures, which is leading to strong sales growth. Consensus estimates indicate sales will likely grow more than 30% in 2010, following 20% and 45% growth in 2009 and 2008, respectively. The company has a strong balance sheet with more than \$700 million of cash and no long-term debt obligations, which should help fund future growth. Return on capital is 30%, reflecting the strength of its innovative market-leading product and patents. Since becoming a publically traded company 10 years ago, the company has grown rapidly and shown an ability to successfully execute its strategy.



Example 2: New product development. This company develops tools that medical researchers use to carry out large scale analysis of genetic variation and function. Gene sequencing is a rapidly growing area in health care that provides valuable information in developing new drugs and clinical tests as well as more effective treatment of diseases. The company's product line ranges from lower-priced models designed for smaller labs to best-in-class systems for large institutions. The company recently introduced a new genetic sequencer that decodes a person's DNA in one week for \$10,000, which is one-fifth the cost of any competing product.

As a result of the new product line, the company is expecting solid sales and earnings growth during the next two years. The company has a history of generating strong returns on capital—currently 20% and expected to rise—and possesses a solid balance sheet with \$400 million of net cash, which can be used to support continued research and development initiatives. As a productivity enhancer with new innovative products, the company fits well within several of our top-down investment themes.

Example 3: User of technology to develop new treatment advances. This pharmaceutical company focuses on diabetes care and is a market leader in insulin therapy. Sales are expected to grow in excess of 10% and earnings are expected to grow in excess of 20% over the coming year as a result of the company's global rollout of a new drug treatment for type 2 diabetes. In addition to insulin and diabetes care products, the company has a biopharmaceutical division focused on homeostasis management, growth hormone therapy, and hormone replacement therapy.

As part of the company's research and development process, it engineers and formulates proteins to develop new insulin analogues and to develop products to treat homeostasis, growth disorders, and inflammation. One of the company's goals is to improve the treatment outcomes in patients affected by diabetes by developing tailor-made proteins for oral administration. The company is working to overcome development issues through its research and development technology infrastructure and via partnerships with other leading companies. The company allocates approximately 15% of its sales to R&D. The company's solid balance sheet (\$1.5 billion of net cash), strong returns on invested capital (30%), and an attractive equity valuation make a compelling case for holding this name.

Conclusion

There is much uncertainty in the health care sector. Significant change looks unavoidable, but with change comes investment opportunities. Several demographic trends support growth estimates for some industries within health care. Our goal is to identify attractive opportunities based on our estimates of intrinsic value, accurately assess the risks, and determine if a company is benefitting from the top-down themes we have identified. Within health care technology, the demographics and several of our top-down themes support our bottom-up valuation estimates. We remain watchful of the sector but are encouraged by many of the opportunities that we are finding within the health care technology industry.

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