February 28, 2012

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Icad Inc

(ICAD-NASDAQ)

ICAD: Q4 Results. IORT Reimbursement Issue Impacting Revenue Ramp.

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	07/29/2011
Current Price (02/28/12)	$0.58
Target Price	**$1.20**

OUTLOOK

The American Medical Association assigned CPT codes for IORT in early October and the expectation was that reimbursement would cover both the IORT radiation therapy separately from the breast surgery. Reimbursement amounts were announced shortly following the assignment of CPT codes - unexpectedly, reimbursement bundled the IORT therapy with the surgery, limiting the economics for radiation oncologists to use Axxent. This has impacted demand for the Axxent system - which is reflected in the lower than estimated revenue in Q4. iCAD met with CMS in December and dialogue continues surrounding breaking out reimbursement for IORT separately from the breast surgery. The hope is that this will happen and be included in the preliminary reimbursement levels beginning on January 1, 2013 - which CMS will communicate by July 1, 2012. We believe a favorable decision by CMS relative to this issue would be a meaningful catalyst to Axxent sales, until then we expect Axxent revenue to remain relatively flat from the Q3/Q4 2011 levels.

SUMMARY DATA

52-Week High	**$1.35**
52-Week Low	**$0.42**
One-Year Return (%)	**-54.69**
Beta	**1.50**
Average Daily Volume (sh)	**48,301**
Shares Outstanding (mil)	**55**
Market Capitalization ($mil)	**$32**
Short Interest Ratio (days)	**0.76**
Institutional Ownership (%)	**8**
Insider Ownership (%)	**14**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**2.5**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2012 Estimate	**N/A**
P/E using 2013 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**N/A,**
Type of Stock	**Small-Value**
Industry	**Comp-Software**

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	7,344 A	6,646 A	8,052 A	6,610 A	28,652 A
2012	6,521 E	6,613 E	8,243 E	7,503 E	28,880 E
2013					45,439 E
2014					62,420 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	-$0.08 A	-$0.09 A	-$0.46 A	-$0.04 A	-$0.67 A
2012	-$0.06 E	-$0.06 E	-$0.04 E	-$0.04 A	-$0.20 E
2013					-$0.15 E
2014					-$0.06 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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WHAT'S NEW…

Q4 RESULTS

iCAD announced financial results for the fourth quarter ending December 31, 2011 on February 28th. Revenue came in significantly softer than both our estimate and management's prior expectations. Relative weakness in both the digital/MRI CAD and Xoft businesses contributed equally to the revenue miss. Despite the disappointing revenue numbers, EPS actually beat our estimate by $0.01 as a result of continued cost-containment.

Revenue
Revenue of $6.61MM was up 4% y-o-y but 22% lower than our $8.5MM estimate.

- **Products revenue:** $4.3MM actual vs. $5.8MM estimate

  - Digital & MRI CAD revenue was $2.5MM, down 36% y-o-y and well below our $3.2MM estimate. Q3 2011 was relatively strong (+15%) and the hope was that this would continue into Q4 - clearly that wasn't the case. While the MRI business continues to show significant growth, mammography, which encompasses the majority of this line-item, continues to contract - growth in iCAD's mammography CAD sales have historically closely tracked that of new digital mammography systems (as reported by FDA's MQSA data - see our graph below) - which continued to be the case in 2011.

  - Film-based revenue was $692k, down 15% but better than our $500k estimate

  - Electronic brachytherapy (Axxent) devices revenue came in at $1,128k, below our $2,100k estimate. The American Medical Association assigned CPT codes for IORT in early October and the expectation was that reimbursement would cover both the IORT radiation therapy separately from the breast surgery. Reimbursement amounts were announced shortly following the assignment of CPT codes - unexpectedly, reimbursement bundled the IORT therapy with the surgery, limiting the economics for radiation oncologists to use Axxent. This has impacted demand for the Axxent system - which is reflected in the lower than estimated revenue in Q4. iCAD met with CMS in December and dialogue continues surrounding breaking out reimbursement for IORT separately from the breast surgery. The hope is that this will happen and be included in the preliminary reimbursement levels beginning on January 1, 2013 - which CMS will communicate by July 1, 2012. We believe a favorable decision by CMS relative to this issue would be a meaningful catalyst to Axxent sales, until then we expect Axxent revenue to remain relatively flat from the Q3/Q4 2011 levels.

- **Services / supplies revenue**: Came in at $2.3MM ($478k Axxent-related, $1,808k CAD-related), up 41% y-o-y but below our $2.7MM ($1.2MM Axxent-related, $1.6MM CAD-related) estimate.

EPS
Despite the miss on revenue, EPS came in slightly ahead of our estimate as a result of continued cost-cutting. Q4 EPS was ($0.04) compared to our ($0.05) estimate. Operating expenses of $6.7 million were well below our estimated $8.9 million. The company has done an excellent job with shedding costs, minimizing the impact of softer than anticipated revenue to the bottom line and slowing cash burn.

Cash
iCAD exited 2011 with $4.6 million in cash and equivalents. Cash used in operations was a mere $678k in Q4. Cash position is further bolstered by a $15 million loan/revenue purchase agreement that iCAD entered into with Deerfield Management in early 2012 (Deerfield also received 2.5MM warrants). We had anticipated that the company would raise capital over the near-term and, for simplicity purposes, had modeled this to come from the sale of common stock - while the Deerfield financing will substantially increase iCAD's interest expense, it will not significantly increase the outstanding share count. As a result, we have adjusted downward our modeled future shares outstanding.

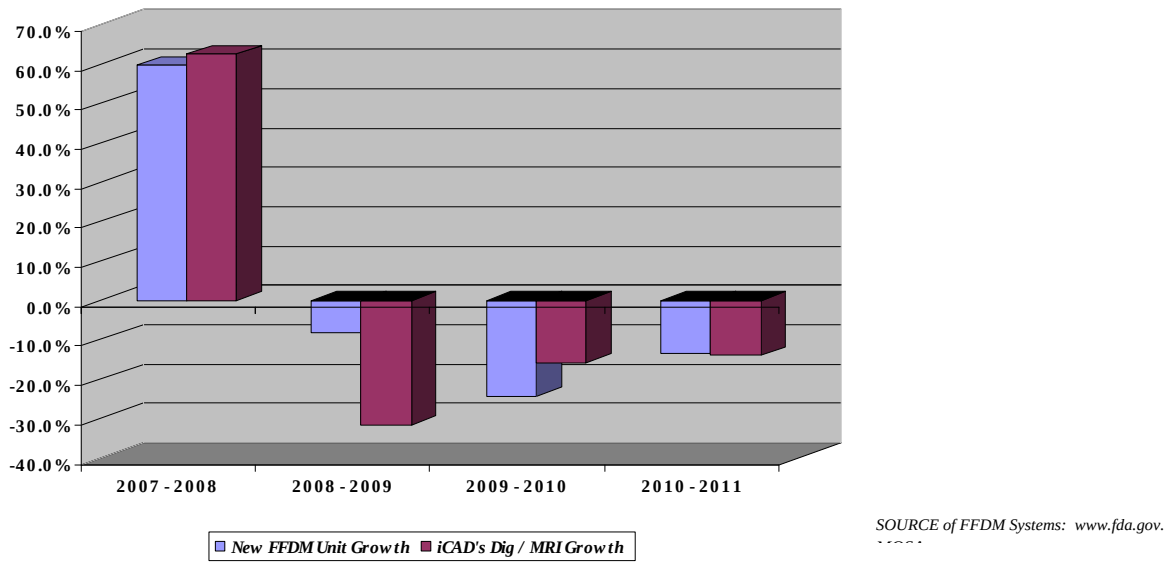
Guidance
Management noted that due to uncertainty surrounding reimbursement of IORT breast brachytherapy that they are not providing financial guidance for 2012 at this time.

We currently model 2012 revenue and EPS of $28.9 million and ($0.20). This is down from $38.5 million and ($0.18) prior to Q4 results. Downward revision to revenue mostly reflects the delay in reimbursement for IORT therapy which affects our ramp in Axxent sales. We have also slightly lowered our modeled revenue in the Digital & MRI CAD business. Our EPS estimate is only moderately affected by our material revision to revenue as we have reduced our modeled operating expenses in 2012 based on the company's success in containing costs.

We now model the brachytherapy business to show a much more substantial ramp in 2013, which assumes more favorable Medicare reimbursement in 2013 for IORT. We also model the Digital & MRI CAD business to return to growth in 2013, benefitting from new product launches and upgrades in both mammography and MRI as well as stabilization of the economic softness overseas.

Going forward, CAD for CTC (colon cancer), breast MRI and prostate MRI could all see an uptick in demand. CTC (VeraLook) should benefit from the recent agreement with Vital Images and other partners. The ACRIN study continues to be re-evaluated and will potentially be a catalyst to eventual Medicare reimbursement - if that happens iCAD's CTC CAD sales could ramp quickly. Prostate MRI (VividLook), while still struggling to gain acceptance despite proven benefits against PSA, may experience slow but steady growth. iCAD has seen some success in terms of sales of VividLook through education about the benefits of prostate MRI CAD which should continue to be the case. Breast MRI (SpectraLook), which remains a significant growth category in Europe, could reverse the recent slide in international sales, especially with strengthening in world economies.

iCAD's mammography revenue growth has been highly correlated to growth in new digital mammography systems



SOURCE of FFDM Systems: www.fda.gov.

VALUATION / RECOMMENDATION

We continue to value iCAD based on competitor price/sales (P/S) multiples. Using analyst's revenue estimates for the years 2012 and 2013, we calculated P/S ratios from imaging (HOLX, MRGE) as well as surgical (VAR, ARAY, ISR) companies. The five companies currently trade at an average P/S-2012 of 2.6x and P/S-2013 of 2.0x.

Our 2012 and 2013 revenue estimates for iCAD are $28.9MM and $45.4MM. On the basis of the comp ratios above, iCAD's stock is valued at between $1.38 (using P/S-2012) and $1.67 (using EV/S-2013). Average of the two is approximately $1.50/share. We continue to use a 20% discount to account for the risk of potential liability related to the FlexiShield lawsuits which values iCAD at $1.20/share. The stock currently trades at about $0.60, as such we are maintaining our Outperform rating.

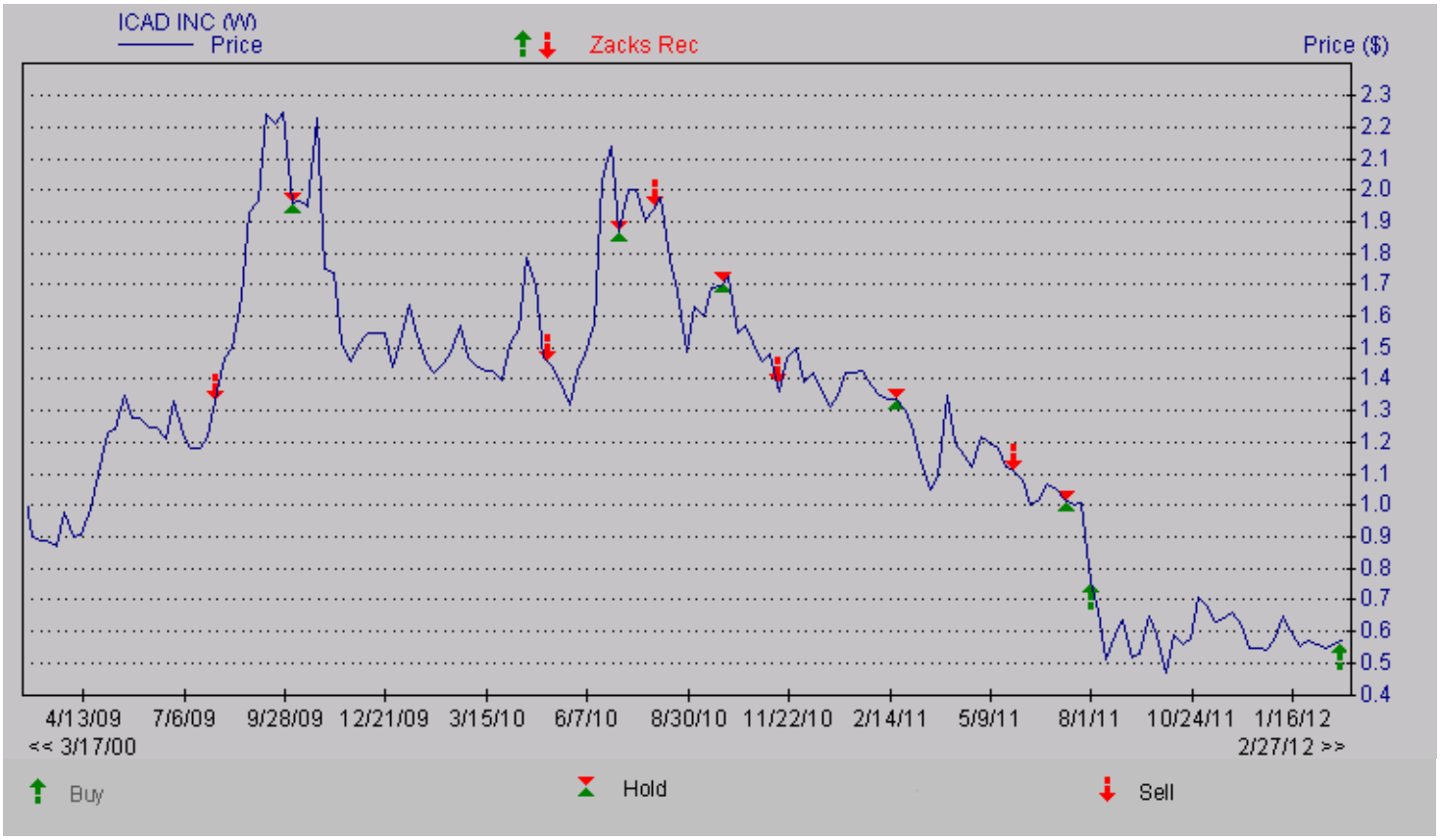
FINANCIAL MODEL

iCAD Inc.

	2011 A	Q1E	Q2E	Q3E	Q4E	2012 E	2013 E	2014 E	2015 E
Digital & MRI CAD revenue	$13,256	$3,232	$3,120	$3,419	$2,871	$12,643	$14,931	$17,052	$19,166
YOY Growth	*-13.9%*	*-14.1%*	*-2.4%*	*-9.8%*	*14.6%*	*-4.6%*	*18.1%*	*14.2%*	*12.4%*
Film-based revenue	$2,362	$488	$502	$575	$601	$2,166	$1,825	$1,644	$1,287
YOY Growth	*-29.2%*	*-5.6%*	*-6.5%*	*-6.7%*	*-13.2%*	*-8.3%*	*-36.6%*	*-26.5%*	*-36.8%*
Electronic brachytherapy	$4,195	$825	$825	$1,453	$1,163	$4,266	$8,590	$12,362	$17,996
YOY Growth	-	-	-	-	-	*1.7%*	*51.5%*	*17.4%*	*17.6%*
Products	$19,813.0	$4,545.4	$4,447.3	$5,447.0	$4,635.2	$19,074.9	$25,346.5	$31,057.3	$38,448.5
YOY Growth	*5.8%*	*-13.3%*	*-1.0%*	*-5.3%*	*7.2%*	*-3.7%*	*32.9%*	*22.5%*	*23.8%*
Xoft	$1,686	$302	$536	$999	$1,305	$3,141	$12,552	$22,949	$42,058
YOY Growth	-	-	-	-	-	*83.2%*	*98.5%*	*27.0%*	*25.9%*
Legacy iCAD	$7,154	$1,674	$1,630	$1,798	$1,562	$6,664	$7,540	$8,413	$9,204
YOY Growth	*22.3%*	*-4.0%*	*-6.6%*	*-3.2%*	*-13.6%*	*-6.8%*	*13.1%*	*11.6%*	*9.4%*
Service and Supplies	$8,840.0	$1,975.7	$2,165.5	$2,796.4	$2,867.5	$9,805.0	$20,092.7	$31,362.3	$51,261.3
YOY Growth	*51.2%*	*-6.1%*	*0.6%*	*21.7%*	*25.4%*	*10.9%*	*104.9%*	*56.1%*	*63.4%*
Total Revenues	$28,652.0	$6,521.1	$6,612.8	$8,243.4	$7,502.7	$28,880.0	$45,439.2	$62,419.6	$89,709.8
YOY Growth	*16.6%*	*-11.2%*	*-0.5%*	*2.4%*	*13.5%*	*0.8%*	*57.3%*	*37.4%*	*43.7%*
Cost of products	$4,788.0	$958.1	$944.4	$1,314.6	$1,091.0	$4,308.1	$6,156.4	$7,564.4	$9,610.2
Products margin	*75.8%*	*78.9%*	*78.8%*	*75.9%*	*76.5%*	*77.4%*	*75.7%*	*75.6%*	*75.0%*
Cost of service/ supplies	$2,906.0	$840.7	$898.1	$1,108.3	$1,104.5	$3,951.6	$6,667.9	$8,818.4	$11,656.7
Service / supplies margin	*67.1%*	*57.4%*	*58.5%*	*60.4%*	*61.5%*	*59.7%*	*66.8%*	*71.9%*	*77.3%*
Amortization	$930.0	$231.0	$231.0	$231.0	$231.0	$924.0	$932.0	$932.0	$932.0
Cost of Revenues	$8,624.0	$2,029.8	$2,073.4	$2,653.9	$2,426.5	$9,183.7	$13,756.3	$17,314.8	$22,198.9
Gross Income	$20,028.0	$4,491.3	$4,539.4	$5,589.5	$5,076.1	$19,696.3	$31,682.9	$45,104.8	$67,510.9
Gross Margin	*69.9%*	*68.9%*	*68.6%*	*67.8%*	*67.7%*	*68.2%*	*69.7%*	*72.3%*	*75.3%*
R&D	$10,792.0	$2,345.0	$2,460.0	$2,520.0	$2,350.0	$9,675.0	$10,875.0	$12,450.0	$14,310.0
% R&D	*37.7%*	*36.0%*	*37.2%*	*30.6%*	*31.3%*	*33.5%*	*23.9%*	*19.9%*	*16.0%*
Selling & Mktg	$13,684.0	$3,130.1	$3,041.9	$3,297.4	$2,851.0	$12,320.4	$16,358.1	$21,222.7	$30,501.3
% Sell&Mktg	*47.8%*	*48.0%*	*46.0%*	*40.0%*	*38.0%*	*42.7%*	*36.0%*	*34.0%*	*34.0%*
G&A	$10,075.0	$1,985.0	$2,181.0	$1,950.0	$1,785.0	$7,901.0	$11,359.8	$13,732.3	$19,287.6
% G&A	*35.2%*	*30.4%*	*33.0%*	*23.7%*	*23.8%*	*27.4%*	*25.0%*	*22.0%*	*21.5%*
Contingent Consideration	($4,900.0)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Goodwill Impairment	$26,828.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Operating Income	($36,451.0)	($2,968.9)	($3,143.5)	($2,177.8)	($1,909.9)	($10,200.1)	($6,910.0)	($2,300.2)	$3,412.0
Operating Margin	*-127.2%*	*-45.5%*	*-47.5%*	*-26.4%*	*-25.5%*	*-35.3%*	*-15.2%*	*-3.7%*	*3.8%*
Other income	($741.0)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Interest income, net	($395.0)	($260.5)	($261.1)	($272.3)	($267.2)	($1,061.0)	($2,112.1)	($1,486.7)	($1,544.0)
Pre-Tax Income	($37,587.0)	($3,229.3)	($3,404.6)	($2,450.1)	($2,177.1)	($11,261.2)	($9,022.1)	($3,786.9)	$1,868.0
Taxes	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Tax Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Net Income	($36,504.0)	($3,229.3)	($3,404.6)	($2,450.1)	($2,177.1)	($11,261.2)	($9,022.1)	($3,786.9)	$1,868.0
YOY Growth	*-486.5%*	*23.1%*	*33.2%*	*90.2%*	*2.2%*	*69.2%*	*19.9%*	*58.0%*	*149.3%*
Net Margin	*-127.4%*	*-49.5%*	*-51.5%*	*-29.7%*	*-29.0%*	*-39.0%*	*-19.9%*	*-6.1%*	*2.1%*
EPS	($0.67)	($0.06)	($0.06)	($0.04)	($0.04)	($0.20)	($0.15)	($0.06)	$0.03
YOY Growth	*-392.8%*	*25.2%*	*35.3%*	*90.6%*	*7.2%*	*70.3%*	*24.3%*	*59.4%*	*147.8%*
Pro-forma adjustments	$21,850.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pro-forma EPS	($0.27)	($0.06)	($0.06)	($0.04)	($0.04)	($0.20)	($0.15)	($0.06)	$0.03
Diluted Shares O/S	54,547	55,850	56,400	57,100	57,500	56,713	60,000	62,000	64,000

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