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Brian Marckx, CFA
bmarckx@zacks.com
Ph (312) 265-9474

Zacks Small-Cap Research

scr.zacks.com

10 S. Riverside Plaza, Ste 1600, Chicago, IL 60606

Icad Inc (ICAD-NASDAQ)

ICAD: DermEbx / Radion Acquisition Looks Like a Real Win

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	04/29/2014
Current Price (07/16/14)	$8.70
Target Price	**$11.00**

OUTLOOK

Revenue grew 17% and op expenses fell 2% in 2013. Therapy revenue up 47% in 2013 with growth coming from strong demand in non-melanoma skin cancer. DermEbx/Radion acquisition should really accelerate Therapy revenue and improve margins further. The Detection segment looks promising to return to long-term growth aided by iCAD's recent strategy shift towards a greater reliance on recurring revenue, services and a conventional software business model, new product launches, and a recently announced development agreement with Invivo (part of Philips Healthcare). New 3D breast tomo product could really accelerate Detection revenue in late 2014/2015.
This coupled with a stringent focus on cost control looks like it is marking an important inflection point for iCAD. Our model and price target are currently under review.

SUMMARY DATA

52-Week High	**$14.11**
52-Week Low	**$5.16**
One-Year Return (%)	**41.69**
Beta	**1.16**
Average Daily Volume (sh)	**95,232**
Shares Outstanding (mil)	**14**
Market Capitalization ($mil)	**$124**
Short Interest Ratio (days)	**1.73**
Institutional Ownership (%)	**44**
Insider Ownership (%)	**15**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**2.6**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2014 Estimate	**N/A**
P/E using 2015 Estimate	**87.0**
Zacks Rank	**N/A**

Risk Level	**High,**
Type of Stock	**Small-Growth**
Industry	**Comp-Software**

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	7,930 A	7,712 A	8,290 A	9,135 A	33,067 A
2014	8,520 A	9,083 E	10,190 E	10,944 E	38,764 E
2015					52,269 E
2016					68,811 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	-$0.07 A	-$0.17 A	-$0.05 A	-$0.41 A	-$0.70 A
2014	-$0.02 E	$0.01 E	$0.00 E	-$0.01 E	-$0.05 E
2015					$0.10 E
2016					$0.47 E

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

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WHAT'S NEW…

DermEbx / Radion Acquisition
iCAD didn't wait long to put their recently beefed-up cash balance (~$40M at Q1 quarter-end) to work, announcing late Tuesday (7/15) that they acquired DermEbx, an electronic therapy services provider which iCAD has had a working relationship with since September 2013, and Radion, Inc., a software solutions provider for oncology practices. While these are two separate companies, they have shared management and have an overlapping shareholder base.

Combined, DermEbx and Radion provide what is essentially a one-stop shop for integrating and servicing electronic brachytherapy for a dermatology practice. DermEbx provides the equipment, know-how, services and access to a network of radiation oncologists while Radion provides a cloud-based workflow, reporting and database tool which has become an integral part of efficiently managing eBx practices.

The deal appears to be not only a seamless fit for iCAD in terms of potential synergies with their existing Therapy business, it will also almost immediately bolt on an additional $12M - $14M in annual recurring, relatively high margin revenue at what looks to be a very reasonable acquisition price. The deal comes with additional kickers as well - including a current backlog of customers which are expected to generate an additional $4M - $6M in annual revenue (and which are expected to come online in the coming months), new services offerings to market to existing (non-DermEbx) customers and also provides iCAD with what they believe are competitive advantages relative to other electronic brachytherapy providers.

And as iCAD has already had a partnering relationship with DermEbx since September 2013, there should be few surprises in terms of expectations or related risks. In fact the relationship with DermEbx has been significant relative to iCAD's rapid growth of skin related eBx volumes and system placements.

The acquisition price of $12.6M will be paid for with $3.8M in cash and 1.2M shares (~$8.8M worth) of iCAD common stock. iCAD expects the acquisition to be immediately accretive to cash flow, as well as revenue and noted in the press release and subsequent earnings call that the current annual recurring revenue run-rate for the two businesses is between $12M and $14M and generates EBITDA margins of 25%+. This revenue run-rate reflects the 23 locations that the acquired companies currently service - in addition to these, iCAD noted that there are an additional 10 locations that are expected to come online in the coming months which are projected to generate, in aggregate, an additional $4M - $6M of annualized recurring revenue. Particularly noteworthy is that this is expected to be recurring revenue - not a one-and-done situation. We think reasonably, this could bolt on an additional $6M - $8M in revenue in the current year and potentially $20M or more in 2015.

Each existing (and expected new) customer of DermEbx generates approximately $400k - $600k in annual recurring revenue - this includes rental of the Axxent controller as well as the entire gamut of services. While customers also have the option of purchasing the controller outright (~$250k - $300k) and paying ~$300k - $400k for annual services, iCAD noted that all existing 23 customers use the rental option - which is expected to also be the case for the additional 10 near-term new customers.

Management indicated the acquired companies and related personnel will largely remain intact as-is, although we expect there may be some synergistic expense opportunities, particularly over the longer term. And while pro formas for the combined companies are not available to provide more specific insight into what exactly this deal may mean in terms of near or potential mid/long term profitability of the company (although it definitely is expected to increase cash flow - which is an obvious benefit), the bolt-on top line numbers are significant, particularly as these should ramp fairly quickly with the backlog of 10 additional customers. And as a substantial portion of the revenue is services and software related, we expect this to be relatively high margin. Add in what appears to be a very reasonable (potentially "cheap") acquisition price of ~1x (or less, if the customer backlog is included) revenue and what we think is already risk-mitigated given iCAD's and DermEbx ongoing relationship, and we think this appears to be a real win for iCAD.

In addition, we think there's near-term complementary upside revenue opportunity with iCAD's existing customer base - particularly as it relates to the Radion Hub software and workflow tools platform. Management noted on the call that they have already been in contact with several of their customers which have expressed potential interest in Radion Hub. Management also believes that Radion Hub offers a point of competitive differentiation relative to their eBx competitors.

This transaction should not only ramp Therapy revenue, it should also improve this segments' profitability. iCAD's therapy business, while a significant contributor to the company's overall top-line growth over the last couple of years, has not been particularly profitable relative to the Detection segment's higher margin software business. This has especially been the case since iCAD recently moved to a more services and subscription based software model. In 2013 the Detection segment turned in an EBITDA margin of 36%, compared to Therapy EBITDA margin of just 9%. Given the expected high margins of the services related revenue from DermEbx and Radion, we expect profitability in the Therapy business to meaningfully improve with this acquisition.

We have not updated our model for the transaction given that there is limited information relative to the combined company's expense base but will do so when more information becomes available. As such, our model and price target remain under review.

FINANCIAL MODEL

iCAD Inc.

	2013 A	Q1A	Q2E	Q3E	Q4E	2014 E	2015 E	2016 E	2017 E
Cancer Detection	$16,905.0	$4,175.0	$4,054.9	$4,251.4	$4,250.2	$16,731.4	$19,547.8	$25,362.4	$31,995.8
YOY Growth	*-2.1%*	*-10.0%*	*6.5%*	*-1.4%*	*2.4%*	*-1.0%*	*16.8%*	*29.7%*	*26.2%*
% of total revenue	*51.1%*	*49.0%*	*44.6%*	*41.7%*	*38.8%*	*43.2%*	*37.4%*	*36.9%*	*39.9%*
Therapy	$16,162.0	$4,345.0	$5,027.8	$5,938.8	$6,694.2	$22,005.8	$32,720.8	$43,449.0	$48,121.3
YOY Growth	*46.7%*	*32.0%*	*28.8%*	*49.2%*	*34.3%*	*36.2%*	*48.7%*	*32.8%*	*10.8%*
% of total revenue	*48.9%*	*51.0%*	*55.4%*	*58.3%*	*61.2%*	*56.8%*	*62.6%*	*63.1%*	*60.1%*
Total Revenues	$33,067.0	$8,520.0	$9,082.7	$10,190.2	$10,944.4	$38,764.2	$52,268.6	$68,811.4	$80,117.1
YOY Growth	*16.9%*	*7.4%*	*17.8%*	*22.9%*	*19.8%*	*17.2%*	*34.8%*	*31.6%*	*16.4%*
Cost of Revenues	$9,981.0	$2,586.0	$2,726.0	$3,088.9	$3,373.1	$11,774.0	$15,025.9	$16,790.6	$18,863.0
Gross Income	$23,086.0	$5,934.0	$6,356.7	$7,101.3	$7,571.3	$26,990.2	$37,242.7	$52,020.8	$61,254.1
Gross Margin	*69.8%*	*69.6%*	*70.0%*	*69.7%*	*69.2%*	*69.6%*	*71.3%*	*75.6%*	*76.5%*
R&D	$7,694.0	$2,027.0	$1,875.0	$2,140.0	$1,828.0	$7,870.0	$10,445.0	$12,214.0	$12,250.0
% R&D	*23.3%*	*23.8%*	*20.6%*	*21.0%*	*16.7%*	*20.3%*	*20.0%*	*17.7%*	*15.3%*
Selling & Mktg	$10,427.0	$2,619.0	$2,770.2	$2,945.0	$3,327.1	$11,661.3	$15,053.3	$19,198.4	$21,231.0
% Sell&Mktg	*31.5%*	*30.7%*	*30.5%*	*28.9%*	*30.4%*	*30.1%*	*28.8%*	*27.9%*	*26.5%*
G&A	$6,740.0	$1,748.0	$1,704.0	$1,701.0	$1,888.0	$7,041.0	$8,572.0	$10,184.1	$11,857.3
% G&A	*20.4%*	*20.5%*	*18.8%*	*16.7%*	*17.3%*	*18.2%*	*16.4%*	*14.8%*	*14.8%*
Operating Income	($1,775.0)	($460.0)	$7.4	$315.3	$528.2	$417.9	$3,172.3	$10,424.4	$15,915.7
Operating Margin	*-5.4%*	*-5.4%*	*0.1%*	*3.1%*	*4.8%*	*1.1%*	*6.1%*	*15.1%*	*19.9%*
Other income	($2,429.0)	$1,140.0	$220.0	$40.0	$40.0	$1,440.0	$200.0	$150.0	$125.0
Interest income, net	($3,277.0)	($817.0)	($111.0)	($297.0)	($290.0)	($1,515.0)	($900.0)	($581.3)	$0.0
Pre-Tax Income	($7,481.0)	($137.0)	$116.4	$58.3	$278.2	($517.1)	$1,822.3	$9,561.8	$16,040.7
Taxes	$126.0	$53.0	$28.0	$14.0	$55.0	$150.0	$246.0	$2,113.2	$4,170.6
Tax Rate	*-1.7%*	*-38.7%*	*24.0%*	*24.0%*	*19.8%*	*-29.0%*	*13.5%*	*22.1%*	*26.0%*
Net Income	($7,607.0)	($190.0)	$88.4	$44.3	$223.2	($667.1)	$1,576.3	$7,448.6	$11,870.1
YOY Growth	*18.9%*	*73.9%*	*104.7%*	*107.5%*	*105.1%*	*91.2%*	*336.3%*	*-372.5%*	*-59.4%*
Net Margin	*-23.0%*	*-2.2%*	*1.0%*	*0.4%*	*2.0%*	*-1.7%*	*3.0%*	*10.8%*	*14.8%*
EPS	($0.70)	($0.02)	$0.01	$0.00	$0.01	($0.05)	$0.10	$0.47	$0.75
YOY Growth	*19.2%*	*75.3%*	*103.4%*	*105.4%*	*103.7%*	*93.3%*	*314.8%*	*-366.5%*	*-57.4%*
Pro-forma adjustments	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pro-forma EPS	($0.70)	($0.02)	$0.01	$0.00	$0.01	($0.05)	$0.10	$0.47	$0.75
Diluted Shares O/S	10,842	11,429	14,870	15,020	15,050	14,092	15,500	15,700	15,900

Brian Marckx, CFA

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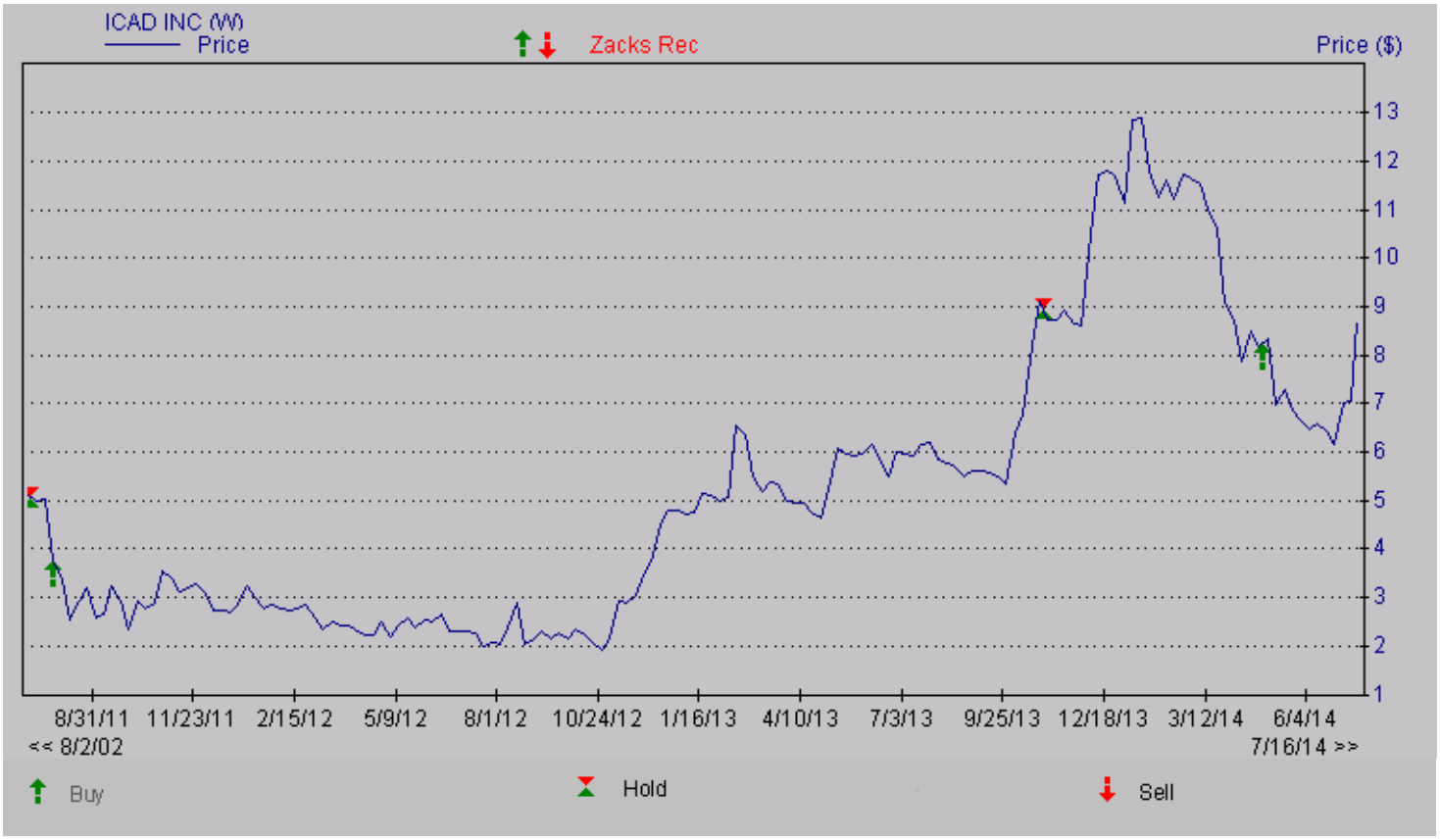

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