July 31, 2014

Zacks Small-Cap Research

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

scr.zacks.com
10 S. Riverside Plaza, Ste 1600, Chicago, IL 60606

Icad Inc (ICAD-NASDAQ)

ICAD: 25% Revenue Growth. Therapy Biz Remains On A Tear…

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	04/29/2014
Current Price (07/31/14)	$9.13
Target Price	**$15.00**

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. We expect this momentum to carry through 2014. 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.
We remain highly positive on ICAD and management's ability to continue to grow the top and bottom lines. Our price target has moved to $15/share with the addition of DermEbx.

SUMMARY DATA

52-Week High	**$14.11**
52-Week Low	**$5.16**
One-Year Return (%)	**32.85**
Beta	**1.16**
Average Daily Volume (sh)	**87,142**
Shares Outstanding (mil)	**14**
Market Capitalization ($mil)	**$129**
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	**53.7**
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	9,667 A	11,332 E	13,159 E	42,678 E
2015					59,962 E
2016					77,637 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	-$0.07 A	-$0.03 E	$0.02 E	-$0.10 E
2015					$0.17 E
2016					$0.44 E

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

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WHAT'S NEW…

Q2 2014 Results: Therapy Biz Maintains Rapid Growth, Acquisition Will Add Additional Fuel….

iCAD (ICAD) announced financial results for the second quarter ending June 30, 2014. Both the Detection and Therapy segments turned in approximately mid-20% revenue growth with Detection benefitting from a large PowerLook order with Therapy revenue continuing to be driven by very strong uptake in non-melanoma skin cancer. We continue to look for strong growth in both segments, with Therapy getting an additional boost from the recent DermEbx/Radion acquisitions (along with continued expected strong organic-related growth) and Detection revenue poised to benefit from additional new product launches - we particularly look for a steepening rate of growth with the tomosynthesis launch (the timeline for which has now been pushed back to 1H 2015).

Q2 2014 marked the eight consecutive quarter of yoy revenue growth. Despite an almost 6% drop in controller revenue (while system sales increased in the quarter, this was more than offset by a reduction in average selling prices) and relatively weak international balloon applicator sales, Therapy revenue was up 24% yoy in Q2 as a result of very strong consumables sales in the U.S. Consumables sales continue to benefit from an increasing degree as both cancer-related system placements and procedural volumes grow. The installed skin-controller base now stands at 70, up from just 15 at the end of 2012 and 49 at the end of 2013. There has been consistent qoq growth in Xoft related service and supplies revenue since Q1 2011 and this continues to make up a larger % of total revenue. We expect this trend to continue as a result of the ever-expanding installed base, higher per instrument utilization, broadening reimbursement, additional clinical data supporting use of eBx in both skin and breast cancer and additional contribution from the DermEbx acquisition.

The majority of growth of the Therapy business continues to come from the skin indication as improved and expanded reimbursement, greater awareness of the therapy and additional positive clinical outcomes data continues to benefit demand. But while skin cancer is the major catalyst of the Therapy division, indications are that breast IORT is gaining additional favor and benefitting from continued greater awareness of its advantages (for those it is appropriate for) relative to whole breast radiotherapy as well as additional clinical data supporting the same.

Total Therapy revenue grew 24% with Detection revenue increasing 27%. Noteworthy is that the 27% growth in Detection was the largest yoy increase in at least the last several years - while this segment continues to be hampered to some extent by the continued erosion of the film-based mammography line, the overall impact has gradually lessened and is now almost a non-issue relative to yoy comparisons. This muted impact, combined with a ~$600k PowerLook order resulted in the robust revenue growth, pushing Detection sales to $4.8M, the highest level since Q4 2011. Over the near-term we continue to look for the services side of Detection to show fairly consistent growth with the product side gaining more momentum with the initial roll-out of the new tomosynthesis product in Europe. We think Detection posts 9% growth in 2014 and 13% growth in 2015.

The Therapy segment remains on a tear. Posting 87% growth in 2012, 47% growth in 2013 and 28% growth through the first six months of 2014. As we've indicated, we see nothing to stop the business from growing at mid-to-high double digit rates given the various catalysts driving adoption of eBx, along with the additional contribution afforded from the DermEbx acquisition. We look for Therapy to post 50% growth in 2014 and 61% growth in 2015.

Guidance
With the Q2 earnings release management provided financial guidance, something that they have not done since late 2011. The company currently expects total revenue in the second half of 2014 to be in the range of $23M - $25M, which implies full-year revenue of $41.2M - $43.2M or growth of 23% - 29%. Management expects EBITDA margin in the second half of 2014 of 10% - 15%, which compares to ~8% in the first six months of 2014 and ~23% in 2013. The revenue and EBITDA margin guidance includes contribution from the DermEbx/Radion acquisitions.

Cash
Excluding changes in working capital, cash from operations was an inflow of $72k. We continue to think the company will be at or near cash flow break even for the full year 2014. Cash balance was $34.9M at the end of Q2. A portion of the cash will be used to fund the $3.8M cash component of the $12.6M purchase price of the DermEbx/Radion acquisitions. As we think the company will be at or near operating cash flow break even in 2014, their cash balance affords them substantial flexibility. Management noted on the Q2 call that they do not expect to

be looking for additional acquisitions, at least in the near-term, and expect instead to reinvest some of the cash in growth of the existing businesses.

Revenue
Q2 revenue of $9.7M was up 25% yoy and about 6% higher than our $9.1M estimate.

- **Cancer Detection(Q2):** $4.8M actual (+27% yoy) vs. $4.1M estimate
  - Total product revenue in cancer detection was about $2.8 million, up from about $1.7 million in Q2 2013 and well ahead of our $1.8 million estimate. We attribute a portion of the beat relative to our number to an unexpected (unexpected to us) $600k PowerLook order that was booked in Q2. Meanwhile, the historical issue of the erosion of Detection revenues from reduced conversion by imaging facilities from film-based to digital mammography has mostly run its course given that revenue related to this had already dropped to (almost) insignificant levels be early 2013. The combination of the large PowerLook order, muted impact from film-to-digital mammography and iCAD's recent shift to a subscription-based model, resulted in Detection posting the highest rate of quarterly yoy growth for at least the last several years.

    In 2012 iCAD implemented a shift in strategy to one with a greater focus on services and subscriptions with the goal of leveraging more recurring revenue and higher margins. We think it's now obvious that this is bearing fruit with Detection services revenue growing 22% in Q4 2012, almost 14% for the full year in 2013 and 7% in 1H 2014. And despite the newly implemented 2.3% medical device tax, iCAD has been able to maintain beefy margins, which we think is a direct benefit of the recent shift towards services/subscriptions.

    We continue to expect the Detection segment to remain on track for sustained growth over the long term. This being fueled by the recent and expected new product launches (PowerLook AMP, CAD for tomosynthesis, etc.), more annual licensing agreements, increased service contracts (to iCAD's 4k+ installed base as well as OEM partners'), partnership deals with OEM's with new products, development projects and service contracts, and the recently penned MRI software development deal with Invivo.

    And as we've noted in the past, while CT colon CAD revenue has yet to gain much traction in the U.S. as a result of a dearth of reimbursement, management recently indicated they are seeing some growth internationally and this remains a viable domestic growth opportunity with sufficient reimbursement. As improvement in the reimbursement picture could improve in the near-term, we see this as one area that could surprise on the upside over the near-term. The additional data from the ACRIN study that were recently published could be a catalyst to eventually gaining Medicare reimbursement for CT colon CAD.

    However, the Detection pipeline product that likely holds the most promise is the company's CAD platform for 3D breast tomosynthesis. ICAD continues to work to complete the initial product, which is expected to be rolled out in the first half of 2015 (pushed back slightly from earlier expectations) in Europe on GE's SenoClair tomosynthesis instruments. SenoClaire received CE Mark in July 2013 and has been submitted for FDA clearance. Upon FDA clearance, ICAD expects to roll-out their tomo platform in the U.S. We think this could be a big winner for ICAD given the criticism and debate over the utility of stand-alone mammography and increased demand for more accurate detection of breast cancer. GE's instrument is billed as producing lower x-ray dose (i.e. - safer) than Hologic's Selenia Dimensions machine (FDA cleared in 2011), currently the only 3D breast tomosynthesis instrument sold in the U.S., providing a real opportunity for GE's machine.

    Our modeled step-up in Detection revenue beginning in 2015 represents meaningful contribution from ICAD's 3D breast tomosynthesis platform.

- **Cancer Therapy (Q2):** $4.8M (+24% yoy) actual vs. $5.0M estimate
  - Cancer therapy revenue in Q2 grew 24% yoy and 11% sequentially. As noted, the main catalysts were services and supplies related revenue and use for non-melanoma skin cancer in the U.S. Unit placements are also being mostly driven for skin cancer. ICAD sold 14 Axxent systems in Q2, compared to 11 in the year-earlier comparable period. Total system placements for skin cancer now stand at 70, up from 49 at the end of 2013.

    As we have noted in the past, growth appears to be coming from several fronts, including more favorable reimbursement, positive clinical outcomes data and greater awareness of the benefits the therapy. This is

particularly benefitting the skin indication, which dually benefits revenue as skin cancer treatment typically requires more than one visit.

Management again noted on the earnings call that they continue to make progress with both regional and national payers on reimbursement. Currently 21 states have a "positive policy" related to non-melanoma skin cancer whereas this stood at just 16 states in May of this year and 10 states in mid-2013. Clearly the reimbursement picture is improving which has almost certainly aided uptake and utilization of Xoft for skin cancer.

Much of the recent growth in Therapy is coming from skin which we think will continue given catalysts such as positive clinical trial data supporting the use of eBx in non-melanoma skin cancer, fairly rapid geographic growth in reimbursement and overall increased awareness (by both dermatologists as well as consumers) of its benefits over traditional surgical excision. ICAD remains very active in promoting at all these levels. Additionally, the DermEbx/Radion acquisitions will immediately contribute significant additional Therapy revenue.

We think it is reasonable to expect that an increase in reimbursement, from both an uptake on the payer side as well as level of reimbursement, will be facilitated with additional positive clinical data. This will be supported by published manuscripts and presentations such as the recent presentations at ASTRO and the American Academy of Dermatology Meeting detailing positive three-year follow up data (low toxicity, no recurrence and excellent cosmetic results) on non-melanoma skin cancer patients (n=187) treated with Xoft. Other data was presented in April of a study with 364 patients (561 lesions) which showed treatment with Xoft in non-melanoma skin cancer results in comparable cure rates compared with standard therapy (fractionation teletherapy, Mohs or excision) with Xoft treated patients having excellent cosmetic results. Strong efficacy and lack of scarring have been major selling points for Xoft in skin cancer.

The company is also now tapping international markets with a handful of sites in Europe and one in Asia currently using Axxent. In April 2013 they announced distribution agreements for parts of China and Russia - launch in which is expected to happen following requisite regulatory approvals - potentially culminating in late 2014 or 2015. More recently they penned a distribution agreement in Canada.

We continue to see tremendous upside in the breast cancer indication. We think utilization remains relatively low and penetration of Axxent in the U.S. breast IORT market is likely only in the low single digits. Greater awareness and improved reimbursement could provide catalysts to ramp penetration, utilization and revenue. Support from a continued flow of positive clinical data, including recently published updated data from the landmark TARGIT-A trial which continued to show non-inferiority of IORT to whole breast radiotherapy at five years follow-up, should further facilitate uptake and support for greater reimbursement.

Despite the slow ramp in breast to-date, demand for Axxent in the breast cancer application is increasing. ICAD clearly remains highly committed to fully exploiting this opportunity and continues to dedicate time and resources towards building awareness and generating additional clinical data in support of the treatment. This includes a multi-center IORT early-stage breast cancer study expected to enroll ~1,000 patients at 50 sites . The study, which is expected to have ~500 patients enrolled could have interim data available in 2015. Positive outcomes from which should provide additional support for utilization and reimbursement of the treatment.

And in addition to skin and breast cancer, the Therapy business should further benefit as additional indications come online, including for cervical cancer which is now still in the early launch phase. This is an area in the Therapy business that could potentially surprise on the upside.

EPS

Q2 EPS, excluding non-cash revaluation of warrant liability and ~$200k in expenses related to the DermEbx/Radion acquisition, of approximately ($0.01) was slightly below our $0.01 estimate.

VALUATION / RECOMMENDATION

We have updated our model for the DermEbx/Radion acquisitions. We now look for EPS of ($0.10) in 2014. We continue to model positive net income and EPS to materialize in 2015.

We continue to value iCAD based on competitor price/sales (P/S) and enterprise value /sales (EV/S) multiples. Using analyst's revenue estimates for the years 2014 and 2015, we calculated P/S and EV/S ratios from imaging (HOLX, MRGE) as well as surgical (VAR, ARAY, ISR, EKTAF) companies. The six companies currently trade at an average P/S-2014 of 4.8x and P/S-2015 of 4.0x and average EV/S-2014 of 4.1x and EV/S-2015 of 3.4x.

Based on the average of the 2014 and 2015 EV/S multiples iCAD is valued at $14.7/share. Based on the average of the 2014 and 2015 P/S multiples iCAD is valued at $14.8/share. We use the average of the two which values iCAD at approximately $15/share. We are maintaining our Outperform recommendation.

FINANCIAL MODEL

iCAD Inc.

	2013 A	Q1A	Q2A	Q3E	Q4E	2014 E	2015 E	2016 E	2017 E
Cancer Detection	$16,905.0	$4,175.0	$4,832.0	$4,439.1	$5,028.6	$18,474.7	$20,911.9	$27,163.0	$34,300.7
YOY Growth	*-2.1%*	*-10.0%*	*26.9%*	*3.0%*	*21.2%*	*9.3%*	*13.2%*	*29.9%*	*26.3%*
% of total revenue	*50.4%*	*49.0%*	*50.0%*	*39.2%*	*38.2%*	*43.3%*	*34.9%*	*35.0%*	*36.0%*
Therapy	$16,162.0	$4,345.0	$4,835.0	$6,893.0	$8,130.0	$24,203.0	$39,050.0	$50,474.0	$60,975.0
YOY Growth	*46.7%*	*32.0%*	*23.8%*	*73.2%*	*63.1%*	*49.8%*	*61.3%*	*29.3%*	*20.8%*
% of total revenue	*48.2%*	*51.0%*	*50.0%*	*60.8%*	*61.8%*	*56.7%*	*65.1%*	*65.0%*	*64.0%*
Total Revenues	$33,519.0	$8,520.0	$9,667.0	$11,332.1	$13,158.6	$42,677.7	$59,961.9	$77,637.0	$95,275.7
YOY Growth	*18.5%*	*7.4%*	*25.4%*	*36.7%*	*44.0%*	*27.3%*	*40.5%*	*29.5%*	*22.7%*
Cost of Revenues	$9,981.0	$2,586.0	$2,837.0	$3,377.1	$3,882.3	$12,682.5	$17,061.1	$20,602.5	$24,077.1
Gross Income	$23,538.0	$5,934.0	$6,830.0	$7,955.0	$9,276.3	$29,995.3	$42,900.8	$57,034.5	$71,198.6
Gross Margin	*70.2%*	*69.6%*	*70.7%*	*70.2%*	*70.5%*	*70.3%*	*71.5%*	*73.5%*	*74.7%*
R&D	$7,694.0	$2,027.0	$2,170.0	$2,182.0	$2,060.0	$8,439.0	$10,445.0	$12,214.0	$12,250.0
% R&D	*23.0%*	*23.8%*	*22.4%*	*19.3%*	*15.7%*	*19.8%*	*17.4%*	*15.7%*	*12.9%*
Selling & Mktg	$10,427.0	$2,619.0	$2,903.0	$3,388.3	$3,921.3	$12,831.6	$17,448.9	$22,126.5	$25,724.4
% Sell&Mktg	*31.1%*	*30.7%*	*30.0%*	*29.9%*	*29.8%*	*30.1%*	*29.1%*	*28.5%*	*27.0%*
G&A	$6,740.0	$1,748.0	$1,923.0	$2,240.0	$2,285.0	$8,196.0	$10,253.5	$12,499.6	$14,481.9
% G&A	*20.1%*	*20.5%*	*19.9%*	*19.8%*	*17.4%*	*19.2%*	*17.1%*	*16.1%*	*15.2%*
Operating Income	($1,323.0)	($460.0)	($166.0)	$144.7	$1,010.0	$528.7	$4,753.4	$10,194.4	$18,742.3
Operating Margin	*-3.9%*	*-5.4%*	*-1.7%*	*1.3%*	*7.7%*	*1.2%*	*7.9%*	*13.1%*	*19.7%*
Other income	($2,429.0)	$1,140.0	($192.0)	$40.0	$40.0	$1,028.0	$200.0	$150.0	$125.0
Interest income, net	($3,277.0)	($817.0)	($614.0)	($582.0)	($599.0)	($2,612.0)	($900.0)	($581.3)	$0.0
Pre-Tax Income	($7,029.0)	($137.0)	($972.0)	($397.3)	$451.0	($1,270.3)	$3,403.4	$9,331.8	$18,867.3
Taxes	$126.0	$53.0	$25.0	$32.0	$55.0	$165.0	$459.5	$1,885.0	$4,905.5
Tax Rate	*-1.8%*	*-38.7%*	*-2.6%*	*-8.1%*	*12.2%*	*-13.0%*	*13.5%*	*20.2%*	*26.0%*
Net Income	($7,155.0)	($190.0)	($997.0)	($429.3)	$396.0	($1,435.3)	$2,944.0	$7,446.7	$13,961.8
YOY Growth	*23.7%*	*73.9%*	*47.0%*	*27.1%*	*109.0%*	*79.9%*	*305.1%*	*-152.9%*	*-87.5%*
Net Margin	*-21.3%*	*-2.2%*	*-10.3%*	*-3.8%*	*3.0%*	*-3.4%*	*4.9%*	*9.6%*	*14.7%*
EPS	($0.66)	($0.02)	($0.07)	($0.03)	$0.02	($0.10)	$0.17	$0.44	$0.82
YOY Growth	*24.0%*	*75.3%*	*59.2%*	*48.8%*	*105.9%*	*84.9%*	*274.3%*	*-151.5%*	*-86.4%*
Pro-forma adjustments	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pro-forma EPS	($0.66)	($0.02)	($0.07)	($0.03)	$0.02	($0.10)	$0.17	$0.44	$0.82
Diluted Shares O/S	10,842	11,429	14,074	15,444	16,490	14,359	16,900	17,000	17,100

Brian Marckx, CFA

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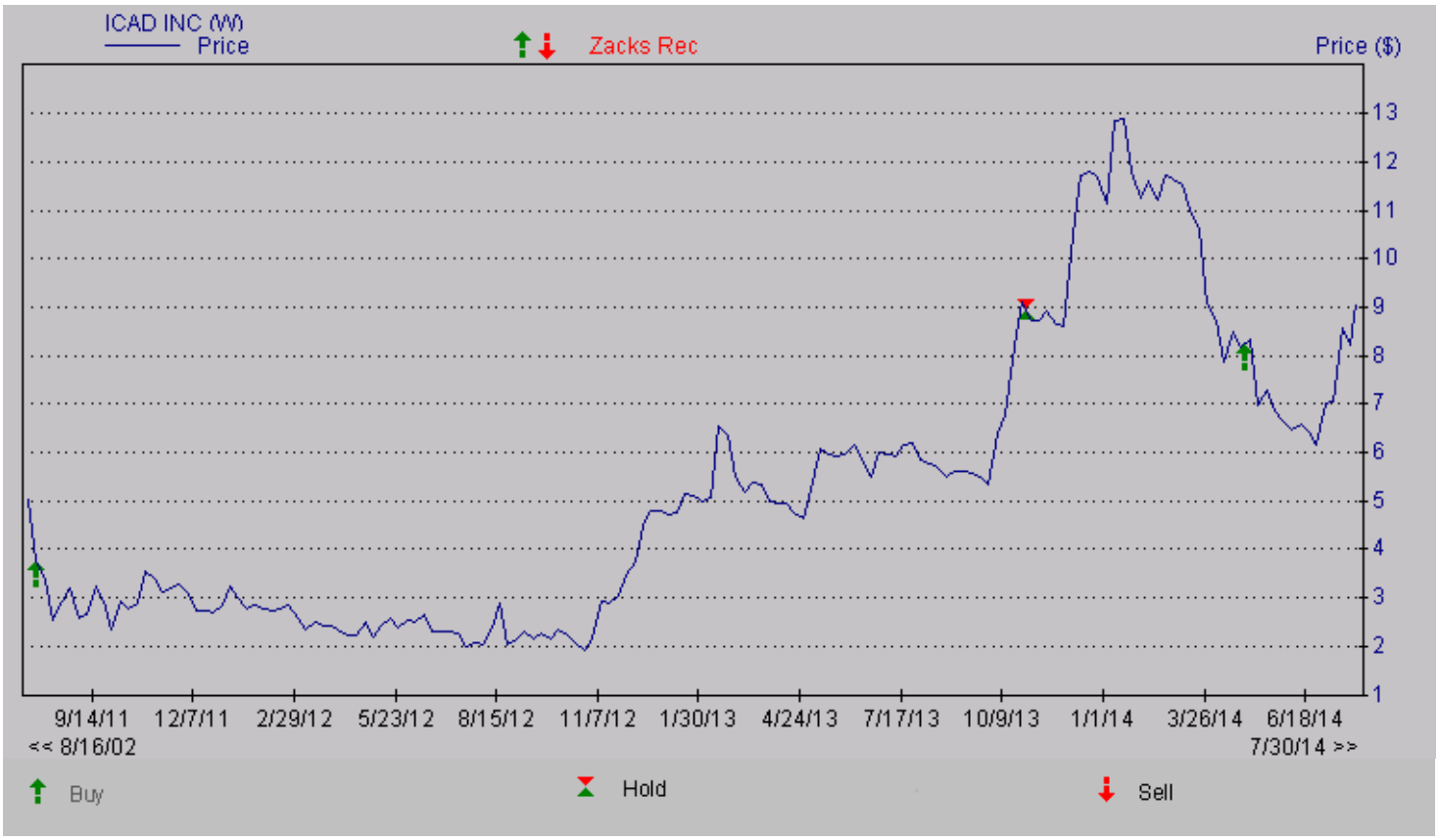

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