May 7, 2014

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Icad Inc (ICAD-NASDAQ)

ICAD: Xoft Service/Supplies +94% As Skin Utilization Ramps

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	04/29/2014
Current Price (05/07/14)	$7.74
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. 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 is $11/share.

SUMMARY DATA

52-Week High	**$14.11**
52-Week Low	**$7.68**
One-Year Return (%)	**37.91**
Beta	**1.18**
Average Daily Volume (sh)	**120,174**
Shares Outstanding (mil)	**14**
Market Capitalization ($mil)	**$108**
Short Interest Ratio (days)	**4.51**
Institutional Ownership (%)	**26**
Insider Ownership (%)	**15**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-0.1**
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	**77.4**
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…

Q1 2014 Results: Xoft Service/Supplies Revenue +94% Driving Therapy Business

iCAD (ICAD) announced financial results for the first quarter ending March 31, 2014. Both Detection and Therapy revenues came in just about dead-on with our respective estimates.

Results continue to come in strong with Q1 marking the seventh consecutive quarter of yoy revenue growth. Revenue in the quarter was largely driven by a continued impressive showing from Therapy service and supplies. Importantly, management noted on the call that Therapy service and supplies, which grew 94% to $2.2M in Q1 and represented 26% of total revenue, is expected to grow from this level throughout the year. Growth in this recurring product revenue is indicative of leveraging the Xoft installed base and increasing utilization of the system for skin as well as breast cancer. 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. At about 15% of total revenue in 2013, we think Xoft services/supplies will account for approximately 27% of total revenue in the current year (+92% growth). We think Xoft related recurring revenue could about triple from 2014 to 2016 as the installed base and utilization continue to expand.

And while console related revenue in Q1 was relatively flat from the year-earlier comparable period, unit placements are inherently lumpy and we expect Xoft product sales to show positive growth for the full year and beyond.

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 (add'l data was recently presented) 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 32% and accounted for all of the 7% revenue growth in Q1. Meanwhile Detection revenue fell 10% yoy. We suspect continued erosion of the film-based mammography (i.e. - legacy line) remains the culprit to the sluggishness as the services side of the Detection business posted 7% growth in the quarter. Through 2014 we think the services side of Detection continues to show fairly consistent growth with the product side gaining more momentum towards the back half, particularly if the new tomosynthesis product is rolled out in Europe during the year.

While we model 17% revenue growth in 2014, we continue to expect a much more dramatic inflection in 2015, with continued strength in Axxent-skin complemented by a full-year (or near full-year) contribution from tomosynthesis sales in Europe and, anticipated, partial year of sales of the initial tomosynthesis platform in the U.S.

Excluding changes in working capital, cash used in operating activities was just $198k. We continue to think the company will be at or near cash flow break even for the full year 2014. Cash balance was $38.4M at Q1 quarter-end and benefitted from the $28.2M (net) capital raise during the quarter. Subsequent to Q1 an additional $1.6M cash came in from Deerfield exercising warrants.

As we noted in our recent investor note, we view the termination of the revenue purchase agreement with Deerfield as a positive development as the revenue share had been a drag on earnings and cash flow. We estimate termination of the agreement will result in approximately $1.1M lower cash interest and ~$1.5M less total interest expense in 2014 compared to if the agreement had remained in place. The revenue share cost iCAD $1.28M in cash interest in 2013 - excluding this and the company would have been nearly operating cash flow break-even last year.

In total, iCAD has almost $40M in cash. iCAD will use $4.1M of this in termination of the revenue share agreement. $3.75M of the $15M Deerfield notes come due at the end of 2014, another $3.75M is due at the end of 2015 and the remaining $7.5M is due at the end of 2016. As we think the company will be at or near operating cash flow break even in 2014 their cash balance affords them substantial flexibility. On the call management alluded to potentially looking acquisitions or other complementary revenue opportunities but didn't provide specifics. We expect we will hear more about their plans for using the cash on future earnings calls.

Revenue
Q1 Revenue of $8.52M was up 7% yoy and just about dead-on with our $8.50M estimate.

- **Cancer Detection(Q1):** $4.2M actual (-10% yoy) vs. $4.1M estimate
  - Total product revenue in cancer detection was about $2.1 million, down from about $2.7 million in Q1 2013 and in-line with our $2.1 million estimate. It's been well detailed that Detection-related revenue growth had been hampered in the past given ICAD's previous focus on squeezing the last vestiges of the benefits from the conversion by imaging facilities from film-based to digital mammography. Film-based revenue, which was as much as $5.8M in 2010 has shown a regular erosion over the past few years, ending 2012 at approximately $1.4M and falling to just ~$600k in 2013. This ~$800k decrease from 2012 to 2013 represents all and more of the ~$360k drop in Detection related revenue over the last year. We point this out as it provides even greater insight into the success that ICAD has had in growing of revenue from the Detection segment's new product lines as well as their services and subscription-based offerings. Had it not been for declining sales of the film-based business, Detection revenue would have posted approximately 3% growth in 2013.

    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 Q1 2014. Management recently noted that the number of customers under service agreements has increased by 14% since the end of 2012. 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. iCAD launched the first two products through this new Invivo relationship in March 2013 and has already seen a meaningful revenue contribution from this. We expect this to further accelerate during 2014.

    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 in 2014. 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 later this year 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 (Q1):** $4.35M (+32% yoy) actual vs. $4.36M estimate
  - Cancer therapy revenue in Q1 grew 32% yoy and 6% sequentially. As noted, the main catalysts were services and supplies related revenue and use for non-melanoma skin cancer. Unit placements are also being mostly driven for skin cancer. Management noted on the call that Axxent system placements for use in skin cancer grew 50% yoy in Q1 2014.

    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 16 states have a "positive policy" related to non-melanoma skin cancer whereas this stood at just 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.

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 culminated in during 2014. 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. Management noted on the call that balloon applicator sales were up 17% yoy in Q1 2014. 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 by the end of Q2 2014, 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

Q1 EPS (excluding non-cash revaluation of warrant liability) of approximately ($0.11) was moderately below our ($0.08) estimate as a result of slightly narrower gross margin and higher operating expenses relative to our estimates.

VALUATION / RECOMMENDATION

We look for EPS of ($0.05) 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) companies. The five companies currently trade at an average P/S-2014 of 4.2x and P/S-2015 of 3.6x and average EV/S-2014 of 3.0x and EV/S-2015 of 2.5x.

Based on the average of the 2014 and 2015 EV/S multiples iCAD is valued at $10.86/share. Based on the average of the 2014 and 2015 P/S multiples iCAD is valued at $11.70/share. We use the average of the two which values iCAD at approximately $11.00/share. We are maintaining our Outperform recommendation.

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

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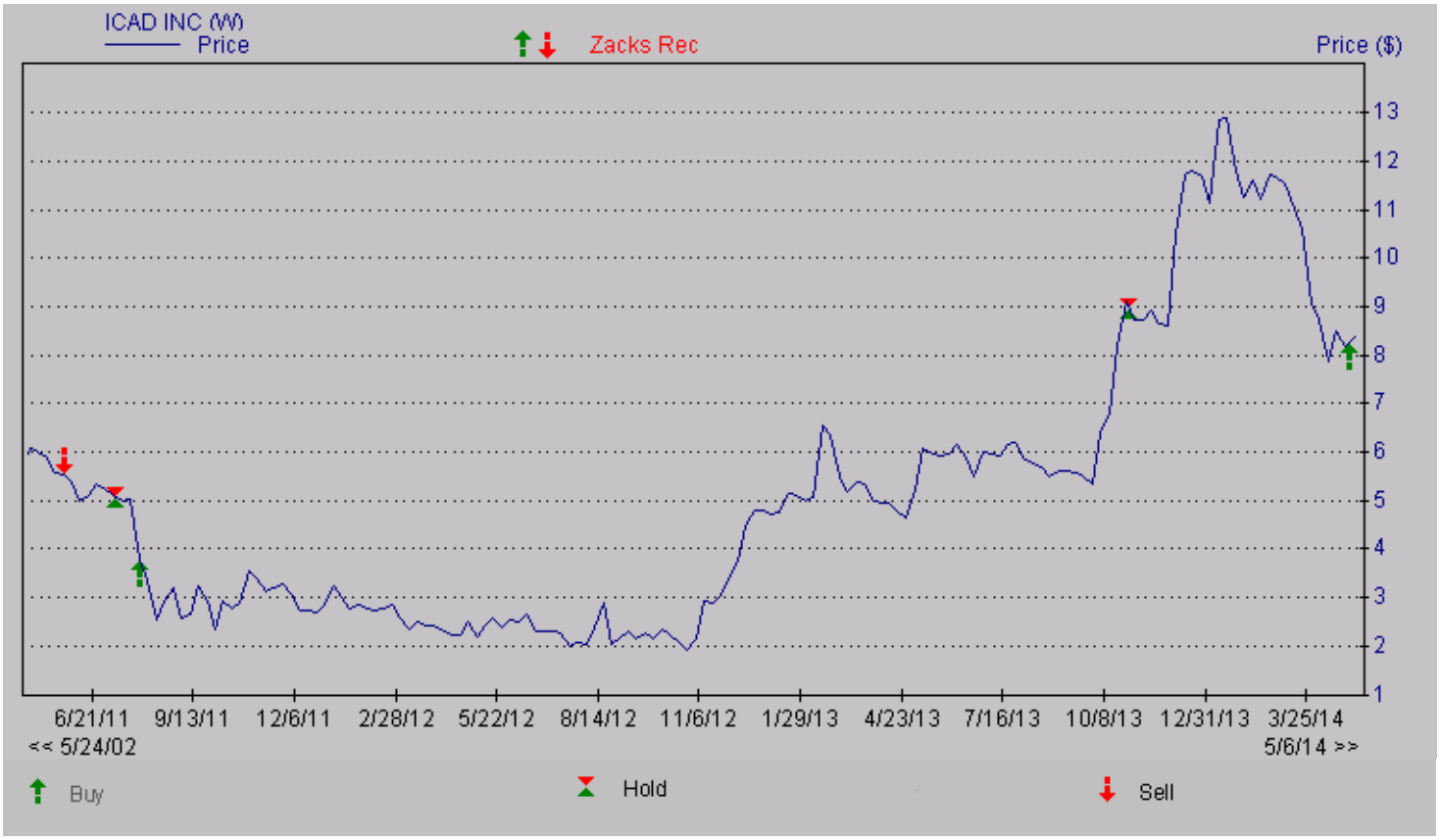

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