May 9, 2012

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Icad Inc (ICAD-NASDAQ)

ICAD: Axxent Revenue Ramping Despite Reimbursement Issue

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	07/29/2011
Current Price (05/09/12)	$0.43
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. While this impacted demand for the Axxent system in Q4, Axxent revenue rebounded in Q1 and is expected to remain strong. This could be further bolstered with more favorable reimbursement for 2013 - an announcement is expected in July. Publication of the five-year TARGIT-A data is expected to be another catalyst to driving Axxent sales.

We are maintaining our Outperform rating.

SUMMARY DATA

52-Week High	**$1.30**
52-Week Low	**$0.40**
One-Year Return (%)	**-54.69**
Beta	**1.50**
Average Daily Volume (sh)	**42,155**
Shares Outstanding (mil)	**54**
Market Capitalization ($mil)	**$23**
Short Interest Ratio (days)	**1.73**
Institutional Ownership (%)	**8**
Insider Ownership (%)	**13**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**0.4**
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	6,343 A	6,928 E	8,088 E	7,733 E	29,163 E
2013					45,016 E
2014					60,639 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	-$0.04 A	-$0.05 E	-$0.04 E	-$0.03 E	-$0.18 E
2013					-$0.14 E
2014					-$0.06 E

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

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WHAT'S NEW…

Q1 RESULTS

iCAD announced financial results for the first quarter ending March 31, 2012 on May 8th. Revenue came in largely in-line with our number, although there was a meaningful difference in the revenue mix (CAD vs. Brachy). The bad news was CAD revenue was significantly weaker than what we had been looking for. The good news, which we think outshines the bad, was that brachytherapy revenue was significantly stronger than our estimates. As brachytherapy is expected to be the major driver of revenue and the bottom line going forward, the outsized growth in this business in Q1 and an encouraging outlook for Axxent and IORT in general lends further support for strong performance going forward.

Noting that it better reflects the cancer businesses that they operate in, beginning with Q1 2012 iCAD began reporting revenue slightly differently. Instead of breaking out revenue by products versus service/supplies as had been done in the past, revenue is now broken out by the two oncology businesses, namely cancer detection (includes CAD and related service) and cancer therapy (includes Axxent and related consumables and services).

Revenue
Revenue of $6.3MM was down 14% y-o-y but in-line with our $6.5MM estimate.

- **Cancer Detection:** $4.3MM actual vs. $5.4MM estimate

  - With the new revenue reporting structure iCAD did not break out Digital & MRI CAD revenue versus Film-based revenue as had been the case previously. Total product revenue in cancer detection was about $2.6MM, down from about $4.3MM in Q1 2011 and well below our $3.7MM estimate. Both mammography and MRI CAD revenue fell y-o-y. The continued slowing pace of film-to-digital mammography is a persistent headwind. Management also noted on the call that their OEM partners (GE, Siemens) have been losing market share to the likes of Hologic, at least some of which relates to more attractive price-points with some of Hologics' offerings. Also noting, however, that new products from their partners being introduced in the coming week should help stem the slide in share. In addition, iCAD will also be rolling out new products and services later this year in the cancer detection segment that they hope will make a meaningful contribution beginning in the current year. In particular a licensing program which may see demand from smaller facilities that can may not be able to justify an outright purchase. And while breast MRI and CT colon CAD revenue have yet to gain much traction, these remain viable growth opportunities. CT colon CAD growth remains hindered by lack of reimbursement in the U.S., although the additional data from the ACRIN study that were recently published could be a catalyst to gaining Medicare reimbursement. Management also noted that there is meaningful demand for their CT colon product in Europe.

- **Cancer Therapy:** $2.0MM actual vs. $1.2MM estimate

  - iCAD sold 6 controllers during the quarter while we were forecasting only one-half that amount. We had expected the IORT reimbursement issue to continue to be a strong headwind. It appears (based on Q1 results, management's general guidance and news flow) that demand is coming despite the uncertainty over Medicare reimbursement. Management noted on the call that demand remains strong for Axxent and the recurring revenue stream from consumables is beginning to flow. During Q1 2012 they sold 125 balloon applicators, up from just 35 in Q1 2011. Management noted that its possible they could sell twice as many Axxent systems in 2012 compared to the 13 systems sold in 2011. We have made some upward revisions to our Therapy revenue.

    Relative to Medicare reimbursement, as a reminder reimbursement amounts for 2012 unexpectedly bundled the IORT therapy with the surgery, limiting the economics for radiation oncologists to use Axxent. This had significantly impacted demand for the Axxent system in Q4 2011, although apparently not as much in Q1. Reimbursement for 2013 could improve, however, and if that happens, could spark even more interest in Axxent. iCAD is actively involved with trying to get more favorable reimbursement for IORT. Preliminary Medicare reimbursement for 2013 is expected to be announced in July 2012.

EPS
Q1 EPS of ($0.04) came in better than our ($0.06) as a result of iCAD's continued cost-cutting efforts. As we've noted previously, management has done an impressive job of taking costs out of the business. Operating expenses were $6.5MM in Q1, about $500k lower than Q4 2011 on only slightly lower revenue. Management indicated on the call that they expect to be able to maintain this ~$6.5MM quarterly run-rate throughout the remainder of 2012. We more conservatively model ~$7.0MM quarterly average in operating expenses for the remainder of 2012.

Cost-control and efficiencies are also apparent in the gross margin which iCAD's been able to maintain at ~70% despite significant slowing of the high-margin CAD business. Management noted on the call that they think they can continue to maintain ~70% throughout 2012. We more conservatively model ~67% gross margin for the full year.

Cash
In early 2012 iCAD into a $15MM loan/revenue purchase agreement with Deerfield Management. iCAD exited Q1 with $15MM in cash and equivalents. Cash used in operations was $3.9MM in Q1. Cash burn is expected to significantly decrease going forward.

BUSINESS UPDATE

Management has shifted gears with the CAD business. In years past the long-hanging fruit were facilities switching from film to digital mammography. With the dwindling number of film-based mammography systems that have yet to convert to digital, growth in this initial target market has slowed. iCAD will still sell into this segment, as well as to customers upgrading their digital systems, but is now dedicating a greater focus to the services and conventional software business model, which provides more opportunity for recurring revenue and higher margins. The focus in this regard is to introducing and selling product upgrades and service contracts to their installed base of approximately 3.3k and in particular, the 2.5k that are using an iCAD product but are not active customers (i.e. - those that don't have a service contract or other revenue stream). iCAD will also be offering customers the option of licensing their products in lieu of an outright purchase, which may be especially attractive to lower volume facilities that can't justify the cost of an outright purchase.

Recent business highlights include;

- In Q3 iCAD expects to roll out a new upgrade product to its installed base affording additional functionality
- iCAD will also start offering a licensing product whereby customers can license the CAD products instead of an outright purchase. iCAD will target the film-to-digital mammography transition market as well as smaller, low volume facilities which may not be able to justify the cost of purchase but can afford to license. Licensing will be available for mammography as well as MRI CAD
- Post-marketing study of Xoft. iCAD launched a post-marketing study of its Axxent system to assess safety and efficacy as compared to external beam therapy. Targeted enrollment is 1,000 patients at as many as 50 sites throughout the U.S. and Europe. Patients will be followed for 10 years with interim data collected regularly.
- iCAD continues to present the benefits of IORT/Axxent which appears to be paying off with the recent announcements that breast cancer centers are adopting the system.

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 2.1x and P/S-2013 of 1.7x.

Using the average of the comp ratios above, iCAD's stock is valued at approximately $1.30/share. We continue to use a slight discount to account for various risks and recommend accumulating the stock up to around $1.20/share. We are maintaining our Outperform rating.

FINANCIAL MODEL

iCAD Inc.

	2011 A	Q1A	Q2E	Q3E	Q4E	2012 E	2013 E	2014 E	2015 E
Cancer Detection	$22,772.0	$4,339.0	$4,207.9	$5,038.8	$5,034.0	$18,590.7	$19,996.1	$22,336.1	$24,811.3
YOY Growth	*-7.3%*	*-28.0%*	*-23.2%*	*-19.6%*	*0.6%*	*-18.4%*	*7.6%*	*11.7%*	*11.1%*
% of total revenue	*79.5%*	*68.4%*	*60.7%*	*62.3%*	*65.1%*	*63.7%*	*44.4%*	*36.8%*	*28.2%*
Therapy	$5,881.0	$2,004.0	$2,721.0	$3,049.4	$2,698.9	$10,572.3	$25,020.1	$38,303.3	$63,105.1
YOY Growth	*-*	*51.8%*	*133.2%*	*70.5%*	*68.0%*	*79.8%*	*136.7%*	*53.1%*	*64.8%*
% of total revenue	*20.5%*	*31.6%*	*39.3%*	*37.7%*	*34.9%*	*36.3%*	*55.6%*	*63.2%*	*71.8%*
Total Revenues	$28,652.0	$6,343.0	$6,928.9	$8,088.1	$7,732.9	$29,162.9	$45,016.2	$60,639.4	$87,916.4
YOY Growth	*16.6%*	*-13.6%*	*4.3%*	*0.4%*	*17.0%*	*1.8%*	*54.4%*	*34.7%*	*45.0%*
Cost of Revenues	$8,624.0	$1,916.0	$2,299.3	$2,568.1	$2,359.4	$9,645.1	$14,028.7	$16,974.2	$21,714.9
Gross Income	$20,028.0	$4,427.0	$4,629.6	$5,520.0	$5,373.5	$19,517.8	$30,987.5	$43,665.2	$66,201.5
Gross Margin	*69.9%*	*69.8%*	*66.8%*	*68.2%*	*69.5%*	*66.9%*	*68.8%*	*72.0%*	*75.3%*
R&D	$10,792.0	$2,212.0	$2,235.0	$2,205.0	$2,190.0	$8,842.0	$9,980.0	$11,900.0	$14,005.0
% R&D	*37.7%*	*34.9%*	*32.3%*	*27.3%*	*28.3%*	*30.3%*	*22.2%*	*19.6%*	*15.9%*
Selling & Mktg	$13,684.0	$2,646.0	$2,910.1	$3,235.3	$2,938.5	$11,729.9	$16,205.8	$20,617.4	$29,891.6
% Sell&Mktg	*47.8%*	*41.7%*	*42.0%*	*40.0%*	*38.0%*	*40.2%*	*36.0%*	*34.0%*	*34.0%*
G&A	$10,075.0	$1,618.0	$1,812.0	$1,950.0	$1,785.0	$7,165.0	$11,254.0	$13,340.7	$18,902.0
% G&A	*35.2%*	*25.5%*	*26.2%*	*24.1%*	*23.1%*	*24.6%*	*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)	($2,049.0)	($2,327.5)	($1,870.2)	($1,540.0)	($8,219.1)	($6,452.4)	($2,192.9)	$3,402.9
Operating Margin	*-127.2%*	*-32.3%*	*-33.6%*	*-23.1%*	*-19.9%*	*-28.2%*	*-14.3%*	*-3.6%*	*3.9%*
Other income	($741.0)	$599.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Interest income, net	($395.0)	($814.0)	($366.0)	($366.0)	($366.0)	($1,912.0)	($2,100.4)	($1,468.9)	($1,526.0)
Pre-Tax Income	($37,587.0)	($2,264.0)	($2,693.5)	($2,236.2)	($1,906.0)	($10,131.1)	($8,552.8)	($3,661.8)	$1,876.9
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)	($2,264.0)	($2,693.5)	($2,236.2)	($1,906.0)	($10,131.1)	($8,552.8)	($3,661.8)	$1,876.9
YOY Growth	*-486.5%*	*46.1%*	*47.1%*	*91.0%*	*14.4%*	*72.2%*	*15.6%*	*57.2%*	*151.3%*
Net Margin	*-127.4%*	*-35.7%*	*-38.9%*	*-27.6%*	*-24.6%*	*-34.7%*	*-19.0%*	*-6.0%*	*2.1%*
EPS	($0.67)	($0.04)	($0.05)	($0.04)	($0.03)	($0.18)	($0.14)	($0.06)	$0.03
YOY Growth	*-392.8%*	*45.6%*	*48.8%*	*91.4%*	*18.7%*	*73.1%*	*20.9%*	*58.6%*	*149.7%*
Pro-forma adjustments	$21,850.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pro-forma income	($14,654.0)	($2,264.0)	($2,693.5)	($2,236.2)	($1,906.0)	($10,131.1)	($8,552.8)	($3,661.8)	$1,876.9
Pro-forma EPS	($0.27)	($0.04)	($0.05)	($0.04)	($0.03)	($0.18)	($0.14)	($0.06)	$0.03
Diluted Shares O/S	54,547	53,880	56,400	57,100	57,500	56,220	60,000	62,000	64,000

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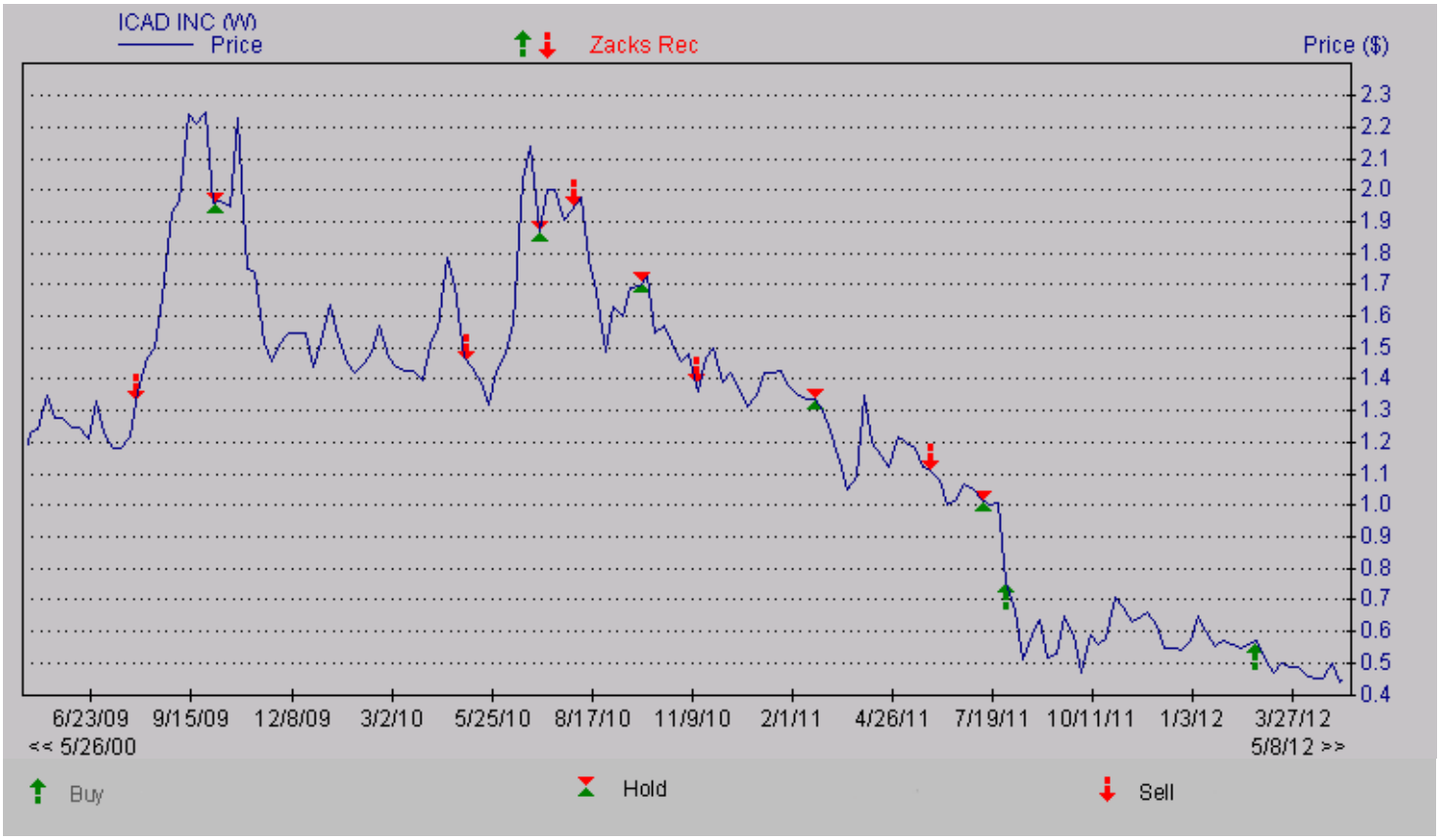

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