May 1, 2015

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Icad Inc

(ICAD-NASDAQ)

ICAD: Therapy Going Gangbusters w/ Popularity of Leasing Option, Drives 55% Revenue Growth in Q1

Current Recommendation	**Buy**
Prior Recommendation	Neutral
Date of Last Change	04/29/2014
Current Price (05/01/15)	$9.25
Target Price	**$15.00**

OUTLOOK

We expect continued momentum in Therapy biz, particularly now with the addition of DermEbx. Leasing option appears to have strong appeal and is driving the top-line as well as providing beefy margins. 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 and new 3D breast tomo product which could really accelerate Detection revenue beginning in late 2015/early 2016.

Mgmt has been very aggressive with driving awareness and at increasing clinical evidence which should help adoption in both the Detection and Therapy segments. We remain highly positive on ICAD and management's ability to continue to grow the top and bottom lines.

SUMMARY DATA

52-Week High	**$11.63**
52-Week Low	**$5.94**
One-Year Return (%)	**7.55**
Beta	**1.22**
Average Daily Volume (sh)	**63,582**
Shares Outstanding (mil)	**16**
Market Capitalization ($mil)	**$143**
Short Interest Ratio (days)	**4.35**
Institutional Ownership (%)	**45**
Insider Ownership (%)	**15**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**7.0**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2015 Estimate	**N/A**
P/E using 2016 Estimate	**25.0**
Zacks Rank	**N/A**

Risk Level	**Above Avg.,**
Type of Stock	**Small-Blend**
Industry	**Comp-Software**

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	8,520 A	9,667 A	12,572 A	13,165 A	43,924 A
2015	13220 A	13774 E	14827 E	15276 E	57,097 E
2016					74,846 E
2017					91,974 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	-$0.02 A	-$0.07 A	$0.02 A	-$0.01 A	-$0.07 A
2015	-$0.12 A	$0.03 E	$0.04 E	$0.05 E	$0.00 E
2016					$0.37 E
2017					$0.69 E

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

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WHAT'S NEW…

Q1 2015 Results: Results Dead-On w/ Our Estimates. Revenue +55%, 71% GM, $2.1M Cash Flow. Mmgt Reiterates 2015 Revenue Guidance of +25% to + 34%....

iCAD (ICAD) announced financial results for the first quarter ending March 31st. Detection and Therapy both turned in a solid performance, pushing revenue up 55% from the year-earlier period and extending the yoy revenue growth streak to 11 quarters. And there were no meaningful surprises relative to our estimates as revenue, gross margin, operating expenses and net income / EPS all came in just about dead-on (excluding non-cash debt retirement expense) with our numbers. Management also reiterated their previously issued 2015 full-year revenue and adjusted EBITDA/revenue guidance of $55M - $59M and 16% - 20%.

And revenue continues to generate meaningful cash. Adjusted EBITDA was $2.5M, equal to 19.2% of revenue. Cash flow from operations (ex-changes in working capital was $2.1M). Management has recently focused on cleaning up the balance sheet, which along with significant cash flow, has meant the retirement of debt. Since Q4 2014 iCAD paid off $15M worth of debt, including $11.3M at the end of Q1 2015 which was well ahead of the due dates ($3.8M was due at 2015 year-end, $7.5M was due at 2016 year-end). At close of Q1, iCAD had $20.3M in cash and aside from capital leases, was virtually debt-free. With expectations of generating positive cash flow for the foreseeable future, the company is well-poised to put their significant cash balance to work.

Therapy Services Continues to Drive Growth: The Therapy-related services segment continues to be the sole driver of the top-line and also provides more at the margin. Leases that came with the DermEbx acquisition created an instant bolt-on in services revenue with growth being fueled by customers appealing to leasing over the significant capital outlay required to purchase a Xoft system. Utilization (in both skin and breast) has also been increasing. The result, Services (i.e. – recurring) revenue in Q1 accounted for 70% of total revenue (up from 51% in Q1 2014) and was 87% (up from 51% in Q1 2014) of Therapy-related sales.

Meanwhile Product sales continue slump, despite a nice uptick in Q1 from Detection-related sales from mammography upgrades and a resurgence of relative strength in MRI and breast density. Detection product sales increased 39% yoy and were the highest since Q4 2011. We continue to model a more moderate level of revenue from Detection product sales throughout the remainder of the current year. Detection services revenue fell 9% in the current quarter and management is still guiding towards low-single digit growth in this segment through the remainder of 2015. We continue to look for Detection to accelerate with an anticipated very warm welcome from the expected 3D tomo launch (Europe this year, U.S. next year) and a resultant meaningful revenue contribution to this segment.

Therapy product sales came down by about 50% on both a yoy and sequential basis in Q1 – which is indicative of the shift in customer preference from capital purchase to a leasing option with the skin cancer application. Management noted, however, that breast IORT continues to mostly follow the capital sale business model (although iCAD recently started offering breast customers a leasing option as well) as does OUS commercialization. As such, as breast IORT continues to gain more traction (which almost certainly should be the case as continued positive clinical data drives further adoption) and iCAD further expands their international geographic footprint (including Spain which is coming online, Russia and China could be next) we think Therapy-related product sales can return to positive growth.

Therapy Going Gangbuster, Detection Should Ramp w/ 3D Tomo: Important to understand is that while Therapy product revenue has slumped as more customers choose leasing over purchasing that overall, the Therapy business continues to experience very rapid growth. Most of this is related to increasing adoption for non-melanoma skin cancer with positive clinical data continuing to drive interest in the platform. Therapy revenue has been on a tear, growing 47% in 2013, 57% in 2014 and 94% through Q1 2015. This has been fueled by the combination of a growing installed base and increasing utilization.

With just barely over 1% of the non-melanoma skin cancer market penetrated and adoption increasing, we see this as holding major opportunity and one that we think will continue to ramp fairly rapidly. And breast IORT, while significantly lagging the uptake of skin, remains a long-term opportunity with multi-year clinical data from several studies demonstrating the effectiveness and overall relatively superior outcomes compared to whole breast radiation therapy.

In Detection, as we have noted in recent updates, the company's 3D tomo products should provide inflection-point opportunity and provide a meaningful revenue tailwind for the foreseeable future given the industry shift towards more effective screening methods. This is what we see as the major driver of the Detection segment for several years out. iCAD's just-announced acquisition of VuCOMP's M-Vu Breast Density software will be incorporated into iCAD's PowerLook platform and will complement both the current 2D mammography systems and could be hugely appealing to 3D tomo customers. Breast density has quickly become an almost indispensable screening tool and, coupled with the rapid uptake of 3D tomo, the combination looks like it could be a big winner for iCAD.

Clinical Data, Awareness Facilitating Ebx Uptake: The Q1 call included management again reiterating their focus on driving awareness, and ultimately increased adoption, of Xoft for skin, breast and other cancers. The quarter included several presentations at industry events and conferences including updated four-year follow-up data from the Ebx non-melanoma skin cancer study (187 patients, 277 lesions) presented at the American Academy of Dermatology annual meeting along with two other skin cancer studies, aggregating to 856 patients and 1,350 lesions.

Also in skin, a presentation in April was made at the European Society of Radiotherapy and Oncology in Barcelona. The presentation, encompassing data from an investigator initiated study (by a physician radiation oncologist in Spain), demonstrated positive outcomes (death and event rates) and corresponds with the launch of Xoft in Spain.

Breast IORT data from the company's ExBRT study was also presented. The presentation, at the American Brachytherapy Society, highlighted data demonstrating almost 95% of patients treated with IORT via Xoft had good or excellent cosmetic outcomes with very low adverse events. As a reminder, the ExBRT ("A Safety and Efficacy Study of Intra-Operative Radiation Therapy Using the Xoft Axxent eBx System at the Time of Breast Conservation Surgery for Early-Stage Breast Cancer") study is comparing patient outcomes in those undergoing Xoft IORT to those undergoing external beam radiation. Patients will be followed for 10 years. ExBRT has enrolled 500 of an expected 1,000 total patients. Additional interim data presentations will follow and could be catalysts to driving even greater uptake of Xoft for breast cancer.

Other studies are also ongoing in both breast and skin. ICAD just recently announced two new studies. The first is a planned ~500 patient study where IORT is used as a boost treatment to patients undergoing external beam radiation. The endpoint is cancer recurrence at five years. The second of the new studies is in skin cancer where Xoft will be compared to surgery with enrollment expected at 600 patients. Primary endpoint is local cancer recurrence at five years.

Positive outcomes data from studies and presentations such as these, demonstrating low recurrence rates and excellent cosmetic results, have been key to driving uptake of Ebx for cancer treatment.

Revenue
Q1 revenue of $13.2M was up 55% yoy and inline with our $13.2M estimate

- **Cancer Detection(Q1):** $4.8M actual (+15% yoy) vs. $4.6M estimate
  - Total product revenue in cancer detection was about $2.9 million, up from about $2.1 million in Q1 2014 and better than our $2.4 million estimate. Management pointed to new business from MRI products, breast density and cancer detection upgrades as the catalysts driving Detection product revenue. As we highlighted over the course of 2014, Detection has been fairly strong recently despite slipping revenue from the services side. While total Detection revenue was relatively strong in Q1 we continue to model barely better than flat growth for the full year 2015, although we think PowerLook AMP and MRI licensing will continue to be significant contributors. However with the launch of the initial 3D breast tomosynthesis products, now expected in Q4 2014 in Europe, we think Detection will see a significant acceleration, particularly once the products are in both the U.S. and Europe (sometime in 2016). Meanwhile, as noted in prior updates, 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 by early 2013.

    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, the recent M-Vu breast density product, 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 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. iCAD has been active in attending and presenting at industry conferences, which have included featuring their VeraLook CTC product.

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 Q4 2015 (pushed back slightly from initial expectations) in Europe on GE's SenoClair tomosynthesis instruments. SenoClaire received CE Mark in July 2013 and FDA clearance in August 2014. Shortly after the European launch, ICAD expects to introduce the product 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 other 3D breast tomosynthesis instrument sold in the U.S., providing a real opportunity for GE's machine.

Our modeled significant step-up in Detection revenue beginning in 2016 represents meaningful contribution from ICAD's 3D breast tomosynthesis platform.

- **Cancer Therapy (Q1):** $8.4M (+94% yoy) actual vs. $8.7M estimate
  - Cancer therapy revenue in Q1 grew 94% yoy and was flat sequentially. ICAD has not broken out legacy from acquired DermEbx revenue, although clearly the acquisition has provided the bulk of revenue growth in the Therapy segment in the last three quarters. Service and supplies revenue (i.e. – instrument leases, consumables and warranties) continues to be the driver of Therapy growth while Therapy product sales have begun to significantly contract. This reflects the new leasing option and customers opting to lease instead of outright purchasing the Xoft console (~$250k). Therapy product sales fell 49% yoy and 49% sequentially but this offset by a 234% yoy and 15% sequential increase in Therapy services revenue.

    Breast IORT continues to mostly follow the capital sale business model (although iCAD recently started offering breast customers a leasing option as well) as does OUS commercialization. As such, as breast IORT continues to gain more traction (which almost certainly should be the case as continued positive clinical data drives further adoption) and iCAD further expands their international geographic footprint (including Spain which is coming online, Russia and China could be next) we think Therapy-related product sales can return to positive growth.

    Therapy revenue is being driven by both an increase in unit placements (leases and sales) as well as growth in utilization. 14 systems were placed during Q1, which per management on the call, is higher than the average new system run rate for the first three quarters of 2014. In addition, utilization, in both skin and breast appears to continue to be growing. In breast, 360 balloon applicators were sold in Q1, up almost 80% from Q1 2014. Management also noted that since the DermEbx acquisition (Q1 2014), growth in utilization in skin has accelerated further. Utilization at sites that use Radion Hub (a cloud-based workflow, reporting and database tool that was part of the DermEbx acquisition) can be tracked – management noted on the call that procedure volume (at locations that launched prior to 2014) increased by 20% sequentially and 31% yoy.

    As we have noted in the past, expansion of the Therapy user base and increase in utilization 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.

    Relative to reimbursement, currently 21 states have a "positive policy" related to non-melanoma skin cancer whereas this stood at just 16 states in May 2014 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. In

addition, a CPT code for electronic brachytherapy specific to skin cancer was recently submitted for review. If established, we would expect this would further benefit uptake of Ebx for non-melanoma skin cancer. Nonetheless, we think it's reasonable to expect further improvement in the reimbursement picture going forward, from both public and private payers.

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. The leasing option, which has quickly proven an attractive alternative to outright purchase of the Xoft console (~$250k), should also help catalyze adoption and resultant Therapy-related revenue growth.

The company is also now tapping international markets with a handful of sites in Europe and one in Asia currently using Axxent. In April 2015 Xoft began its introduction in Spain. In April 2013 ICAD announced distribution agreements for parts of China and Russia - launch in which is expected to happen following requisite regulatory approvals - potentially culminating in 2015. A distribution agreement in Canada is also now in place.

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. Positive trial data has been the foundation for awareness-building and uptake and adoption of Ebx in skin and breast and has also supported improved reimbursement policy and rates. With several studies, both sponsored and unrelated to ICAD, still ongoing and producing updated data on a regular basis, this should further drive greater adoption and facilitate payers' interest in the therapy.

Recently updated four-year follow-up data from the Ebx non-melanoma skin cancer study (187 patients, 277 lesions) as well as two other skin cancer studies, aggregating to 856 patients and 1,350 lesions, were presented at the American Academy of Dermatology annual meeting.

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EPS

Q1 EPS, excluding $1.7M in non-cash debt retirement expense (related to the repayment of the entire $11.3M in o/s Deerfield notes) of approximately ($0.00) was inline with our $0.00 estimate.

Cash

Excluding changes in working capital, cash from operations was an inflow of $2.1M in Q1. Free cash flow, which accounts for capex related to Xoft systems that are capitalized and leased, was $1.5M.

As noted the balance sheet was cleaned up even further. Since Q4 2014 iCAD paid off $15M worth of debt, including $11.3M at the end of Q1 2015 which was well ahead of the due dates ($3.8M was due at 2015 year-end,

$7.5M was due at 2016 year-end). At close of Q1, iCAD had $20.3M in cash and aside from capital leases, was virtually debt-free.

The cash cushion provides significant flexibility, particularly as we think the company, despite an expected increase in operating expenses (some of which relates to the new clinical studies) will generate positive cash flow in 2015 (and beyond). Management has previously noted 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.

VALUATION / RECOMMENDATION

We have made only insignificant adjustments to our model following Q1 results. We look for 2015 revenue of $57.1 million, roughly mid-range of management's guidance and EPS of $0.00 (ex the non-cash debt retirement expense, our 2015 EPS estimate is $0.11).

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 2015 and 2016, 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-2015 of 4.9x and P/S-2016 of 3.2x and average EV/S-2015 of 3.9x and EV/S-2016 of 2.7x.

Based on the average of the 2015 and 2016 EV/S multiples iCAD is valued at $14.0/share. Based on the average of the 2015 and 2016 P/S multiples iCAD is valued at $15.6/share. We use the average of the two which values iCAD at approximately $15/share. We are maintaining our Buy recommendation.

FINANCIAL MODEL

iCAD Inc.

	2014 A	Q1A	Q2E	Q3E	Q4E	2015 E	2016 E	2017 E	2018 E
Cancer Detection	$18,604.0	$4,788.0	$4,657.1	$4,970.2	$4,858.9	$19,274.1	$24,872.1	$30,949.6	$35,659.1
YOY Growth	*10.1%*	*14.7%*	*-3.6%*	*0.7%*	*4.2%*	*3.6%*	*29.0%*	*24.4%*	*15.2%*
% of total revenue	*42.4%*	*36.2%*	*33.8%*	*33.5%*	*31.8%*	*33.8%*	*33.2%*	*33.7%*	*34.4%*
Therapy	$25,320.0	$8,432.0	$9,117.0	$9,857.0	$10,417.0	$37,823.0	$49,974.0	$61,025.0	$68,122.0
YOY Growth	*56.7%*	*94.1%*	*88.6%*	*29.1%*	*22.5%*	*49.4%*	*32.1%*	*22.1%*	*11.6%*
% of total revenue	*57.6%*	*63.8%*	*66.2%*	*66.5%*	*68.2%*	*66.2%*	*66.8%*	*66.3%*	*65.6%*
Total Revenues	$43,924.0	$13,220.0	$13,774.1	$14,827.2	$15,275.9	$57,097.1	$74,846.1	$91,974.6	$103,781.1
YOY Growth	*31.0%*	*55.2%*	*42.5%*	*17.9%*	*16.0%*	*30.0%*	*31.1%*	*22.9%*	*12.8%*
Cost of Revenues	$12,697.0	$3,858.0	$4,019.8	$4,298.5	$4,440.5	$16,616.8	$20,813.4	$24,864.0	$27,208.8
Gross Income	$31,227.0	$9,362.0	$9,754.3	$10,528.7	$10,835.4	$40,480.3	$54,032.7	$67,110.6	$76,572.3
Gross Margin	*71.1%*	*70.8%*	*70.8%*	*71.0%*	*70.9%*	*70.9%*	*72.2%*	*73.0%*	*73.8%*
R&D	$8,490.0	$2,256.0	$2,458.0	$2,671.0	$2,777.0	$10,162.0	$11,966.0	$12,511.0	$12,898.0
% R&D	*19.3%*	*17.1%*	*17.8%*	*18.0%*	*18.2%*	*17.8%*	*16.0%*	*13.6%*	*12.4%*
Selling & Mktg	$12,526.0	$3,830.0	$3,898.1	$4,033.0	$4,124.5	$15,885.5	$20,807.2	$24,833.2	$27,502.0
% Sell&Mktg	*28.5%*	*29.0%*	*28.3%*	*27.2%*	*27.0%*	*27.8%*	*27.8%*	*27.0%*	*26.5%*
G&A	$9,396.0	$2,833.0	$2,820.0	$2,944.0	$2,951.0	$11,548.0	$12,902.0	$13,941.0	$15,044.0
% G&A	*21.4%*	*21.4%*	*20.5%*	*19.9%*	*19.3%*	*17.1%*	*16.1%*	*15.2%*	*15.2%*
Operating Income	$815.0	$443.0	$578.2	$880.7	$982.9	$2,884.8	$8,357.5	$15,825.4	$21,128.3
Operating Margin	*1.9%*	*3.4%*	*4.2%*	*5.9%*	*6.4%*	*5.1%*	*11.2%*	*17.2%*	*20.4%*
Other income	$969.0	($1,714.0)	$0.0	$0.0	$0.0	($1,714.0)	$150.0	$125.0	$0.0
Interest income, net	($2,640.0)	($507.0)	($79.0)	($75.0)	($75.0)	($736.0)	($374.0)	$25.0	$104.0
Pre-Tax Income	($856.0)	($1,778.0)	$499.2	$805.7	$907.9	$434.8	$8,133.5	$15,975.4	$21,232.3
Taxes	$153.0	$79.0	$69.9	$112.8	$127.1	$388.8	$1,789.4	$4,153.6	$6,369.7
Tax Rate	*-17.9%*	*-4.4%*	*14.0%*	*14.0%*	*14.0%*	*13.5%*	*22.0%*	*26.0%*	*30.0%*
Net Income	($1,009.0)	($1,857.0)	$429.3	$692.9	$780.8	$46.0	$6,344.1	$11,821.8	$14,862.6
YOY Growth	*85.9%*	*-877.4%*	*143.1%*	*-152.9%*	*913.4%*	*104.6%*	*-13690.0%*	*-86.3%*	*-25.7%*
Net Margin	*-2.3%*	*-14.0%*	*3.1%*	*4.7%*	*5.1%*	*0.1%*	*8.5%*	*12.9%*	*14.3%*
EPS	($0.07)	($0.12)	$0.03	$0.04	$0.05	$0.00	$0.37	$0.69	$0.86
YOY Growth	*89.3%*	*-615.8%*	*136.5%*	*-147.5%*	*852.4%*	*104.0%*	*-13224.6%*	*-85.3%*	*-25.0%*
Pro-forma adjustments	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pro-forma EPS	($0.07)	($0.12)	$0.03	$0.04	$0.05	$0.00	$0.37	$0.69	$0.86
Diluted Shares O/S	14,348	15,605	16,600	16,700	16,800	16,426	17,000	17,100	17,200

Brian Marckx, CFA

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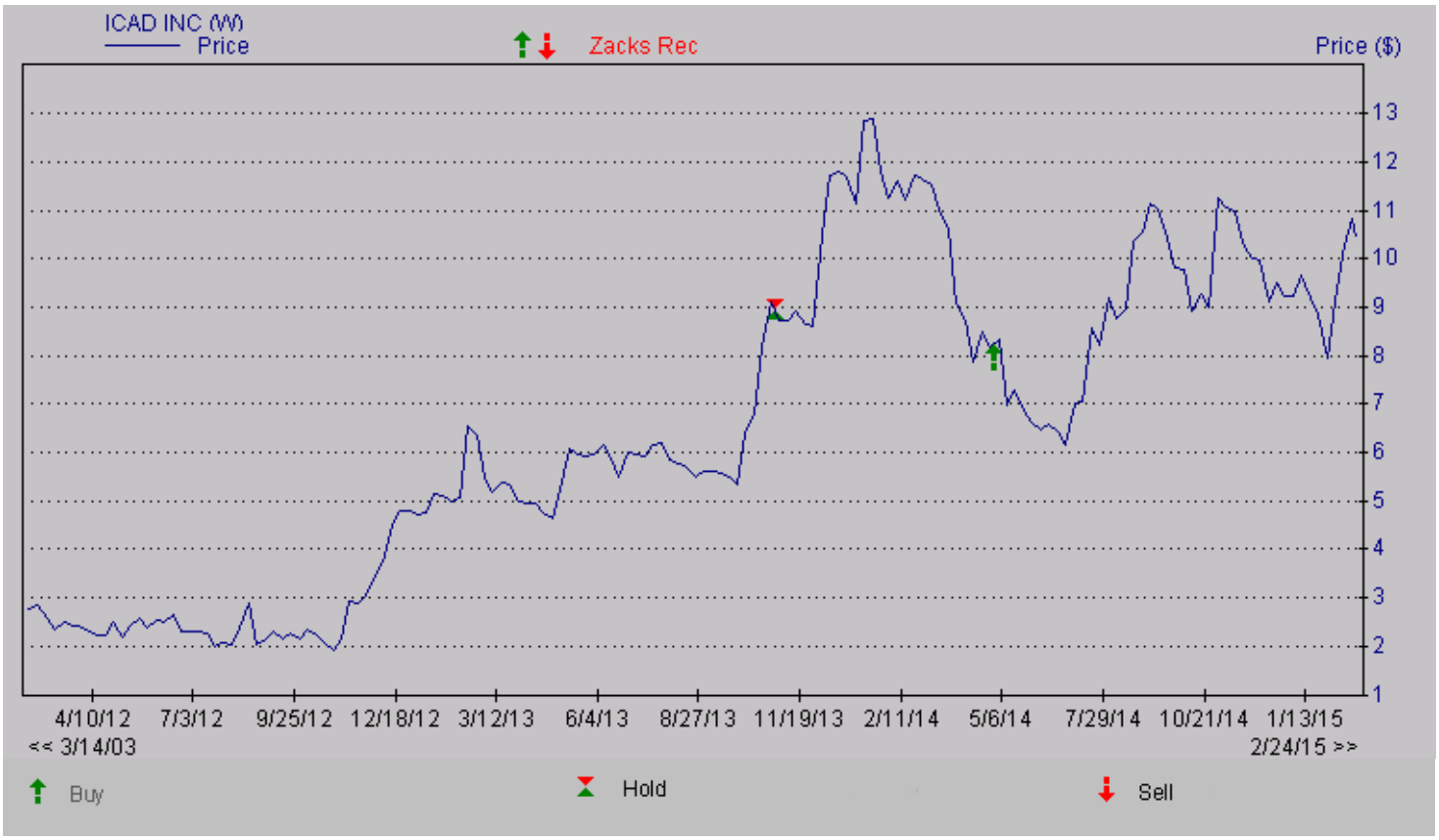
HISTORICAL ZACKS RECOMMENDATIONS



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