Zacks Small-Cap Research

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LED Medical Diagnostics (V.LMD)

V.LMD: Q2 Results: Strong Revenue, Gross Margin. Cost-Control in OpEx

We have revenue CAGR of about 22% from 2015 through 2019, then dropping to a low-double digit average through 2025. We use a 10% discount rate and 2% terminal growth rate. Based on DCF, LED is value at approximately $0.90/share.

Current Price (08/09/2016)	$0.10
Valuation	**$0.90**

OUTLOOK

LED Medical's VELscope is the world's leading device used for oral cancer screening with 13k units sold and ~30 million scans done since the 2006 launch. Demand is fueled by a quantity of clinical data and recommendations from influential sources supporting use of the device as well as increased awareness of the dangers of oral cancer. Despite their leading position, the market remains barely penetrated, offering significant upside opportunity. Recent greater international focus should provide incremental revenue growth.

LED recently revamped its sales strategy to one with multiple distributors and complemented by a direct sales force. This is expected to further expand their footprint, drive utilization and increase profitability. LED is also now highly focused on bringing new products to market, specifically in the dental imaging market. These products have already begun to make a major contribution to revenue and are expected to be a significant driver of growth for the foreseeable future.

SUMMARY DATA

52-Week High	**$0.20**
52-Week Low	**$0.07**
One-Year Return (%)	**-53**
Beta	**-0.61**
Average Daily Volume (sh)	**87,587**
Shares Outstanding (mil)	**112**
Market Capitalization ($mil)	**11**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**N/A**
Dividend Yield (%)	**N/A**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2016 Estimate	**N/A**
P/E using 2017 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**N/A**
Type of Stock	**Large-Growth**
Industry	**Med/Dental-Supp**

ZACKS ESTIMATES

Revenue
(in '000)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	$2443 A	$3269 A	$1783 A	$5640 A	$13135 A
2016	$2153 A	$3661 A	$2321E	$6147 E	$14283 E
2017					$18914 E
2018					$25882 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	-$0.02 A	-$0.02 A	-$0.01 A	-$0.01 A	-$0.05 A
2016	-$0.02 A	-$0.01 A	-$0.01 E	-$0.01 E	-$0.05 E
2017					-$0.03 E
2018					-$0.02 E

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

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Q2 2016 Financial Results: ***Strength in Revenue. Gross Margin. Cost-Control in OpEx…***

LED reported financial results for the second quarter ending June 30th. Revenue, as expected following the company's preannouncement in July, came in at $3.7M, representing yoy and sequential growth of 12% (from $3.3M in Q2 2015) and 70% (from $2.2M in Q1 2016). It was also inline with our prior-to-preannouncement estimate of $3.6M. Importantly, operating expenses were relatively very low, particularly relative to the level of revenue. And while gross margin was slightly lower than what we were looking for, it was relatively healthy compared to recent history and this is despite some negative impact from write-down of obsolete equipment in the quarter. We continue to model improving financials - including growth in revenue, some incremental widening of gross margin and additional leverage gains from the operating base.

Q2 revenue of $3.7M is a 70% and 12% increase from Q2 2015 and Q1 2016, respectively, and inline with our estimate. Similar to Q2, timing of orders contributed in part to the month-to-month variability. We expect this to continue and note that Q3 has historically experienced relatively moderate sales activity while Q4 is typically the strongest buying season for dental equipment. As such, we think revenue may dip in Q3 but expect a strong rebound in the final quarter of the year.

Also noteworthy as it relates to revenue is that no customer accounted for 10% or more of total revenue in the most recent quarter. This compares to 14% in the comparable prior year period. The reduced customer concentration reduces A/R risk and may have the added benefit of helping to smooth revenue volatility.

Q2 gross margin, at 29% was slightly below our 31% estimate but, as compared to recent history - including 27% for all of 2015 and 25% in Q1 of this year, was still relatively strong. And had it not been for (per the MD&A) "the Company liquidating obsolete equipment during the three months ended June 30, 2016", Q2 gross margin may have been even stronger. While we expect growth in the digital imaging segment to limit upside in gross margin, we think there should be some benefit from higher sales volumes and forecast GM of 30% for the full year 2016 compared to 27.2% in 2015.

Operating expenses, at $2.1M were at the lowest level on an aggregate basis since Q3 2015 and at 56.3% of sales, well below historical averages (65% in 2015, 99% in 2014, 173% in 2013). Additional cost-control measures, coupled with expectations of continued revenue growth and incremental upside in gross margins should push the company closer to profitability.

Cash used in operating activities was $821k and $1.5M in the three and six months ending June 30th. LED exited Q2 with $364M in cash and equivalents. Subsequent to quarter end the company issued CDN$385k 13%, 12-month senior secured debt (along with 250k common shares) to Bloom Burton Healthcare Lending via private placement. They also had an A/R balance of just over $1M, 88% of which is current (<30days) and 98% of which is less than 60 days old. As we have previously noted, we continue to expect LED to look to raise additional capital in 2016.

Other recent noteworthy events include;

> June 20th: announced British Columbia-based Biocare Health Supply will be exclusive distributor of VELscope Vx in China and Hong Kong. Biocare has teamed with National Medicines Prospect Dentech Co of Beijing, which the press release notes as being the largest dental equipment distributor in China. Initial sales are expected to begin in August of this year. As a reminder, VELscope VX received regulatory approval in China in August 2015.

This fits with LED's recently implemented strategy to beef-up their overall international VELscope effort given that the ex-U.S. market represents about two-thirds of the total market opportunity. We expect LED will look to gain marketing approval in other international territories, particularly spots in Europe and Asia given the potential for outsized growth in those areas. Following gaining requisite regulatory approvals, the next step will be to consummate distribution agreements in those regions of the world. While we model only incremental progress on this front in 2016 (given that regulatory approvals, in particular, can be a several-quarter process), we think next year may see additional and more significant contribution from growth in international VELscope sales.

> July 6th: issued CDN$385k 13%, 12-month senior secured debt (along with 250k common shares) to Bloom Burton Healthcare Lending via private placement.

> July 12th: for the sixth consecutive year VELscope Vx was given the Cellerant Best of Class Technology Award - previously known as the Pride Best of Class Technology Award, as the leading device in the oral

screening category. Winner of the awards were chosen by a panel of five dentists which included (per the press release), "Dr. Shuman; Dr. Flucke, writer, speaker, and Technology Editor for Dental Products Report; Paul Feuerstein, DMD, writer, speaker and Technology Editor for Dentistry Today; Marty Jablow, DMD, technology writer and consultant for Dr. Bicuspid; and Parag Kachalia, DDS, Vice-Chair of Preclinical Education, Research and Technology, University of Pacific School of Dentistry."

Recent highlights on the operational front include;

- publication in the online version of *JAMA – Otolaryngology – Head and Neck Surgery* of the surgical margins study (more detail below)
- the digital imaging business has been on a tear, fueled in large part from the rapidly growing product portfolio. The latest addition to their U.S. portfolio came in March of this year when LED announced that their new Tuxedo digital intraoral radiography system received FDA 510(k) clearance, allowing it to be sold in the U.S. Tuxedo is as billed as providing some of the highest image quality of any intraoral sensors on the market. Tuxedo, like most of LED's imaging portfolio, looks to exploit the digital imaging market growth driven by the shift from analog dental film and imaging
- successful resolution to FDA's May 2014 Warning Letter regarding marketing language of VELscope Vx

Surgical Margins Study Published Online in *JAMA – Otolaryngology – Head and Neck Surgery* :

Results of a 246-patient retrospective study assessing the utility of fluorescence visualization (FV) via VELscope in reduction of locoregional recurrence of cancer and improving overall survival in patients undergoing oral cancer surgery was published online in the *Journal of the American Medical Association – Otolaryngology – Head and Neck Surgery.*

FV was used to determine surgical margins. It is important to determine exactly where the lesion should be excised as the majority of oral cancer surgeries inadvertently leave some cancerous tissue behind, due in large part to the fact that some tissue is beneath the surface and not visible to the naked eye of the surgeon. Patients 18 years and older diagnosed with high grade lesions or squamous cell carcinoma of less than 4cm and which underwent oral surgery were included. 154 of the 246 underwent surgery with FV guidance while the other 92, the control group, underwent conventional surgery. There were no significant differences between the FV and control groups in age, smoking history, anatomical site of the lesion, tumor size, and previous oral cancer.

Results: The use of fluorescence visualization in determining surgical margin significantly reduced the rate of localized cancer recurrence in high grade and early stage oral cancers.

Per JAMA Otolaryngology Head Neck Surg. Published online January 14, 2016. doi:10.1001/jamaoto.2015.3211 (http://bit.ly/1WXRldE): Among the 156 patients with squamous cell carcinoma , the 92 patients in the FV group showed significant reduction in the 3-year local recurrence rate, from 40.6% (26 of 64 patients) to 6.5% (6 of 92 patients) (P□<□.001). Among the 90 patients with high-grade lesions, the 62 patients in the FV group showed a reduction in local recurrence rate from 11 of 28 patients (39.3%) to 5 of 62 patients (8.1%) (P□<□.001). The data also indicated that, compared with conventional surgery, the FV-guided approach for squamous cell carcinoma was associated with less regional failure (14 of 92 patients [15.2%] vs 16 of 64 [25.0%]; P□=□.08) and death (12 of 92 patients [13.0%] vs 13 of 64 [20.3%]; P□=□.22), although these differences were not statistically significant.

This study provides additional validation of the utility of VELscope in identifying the presence of cancer. And while commercial use VELscope has been mostly to aid dentists with identification of oral mucosal abnormalities, including those associated with oral cancer, there is a growing body of evidence to suggest it may have broader applications. This includes with identifying surgical margins.

Along with this recently published study, Dr. Catherine Poh was also the lead investigator of *Fluorescence Visualization Detection of Field Alterations in Tumor Margins of Oral Cancer Patients,* a study published in Clinical Cancer Research in 2006. This was one of the first studies offering substantial evidence that VELscope can significantly improve on normal white light visualization of detection of oral cancer.

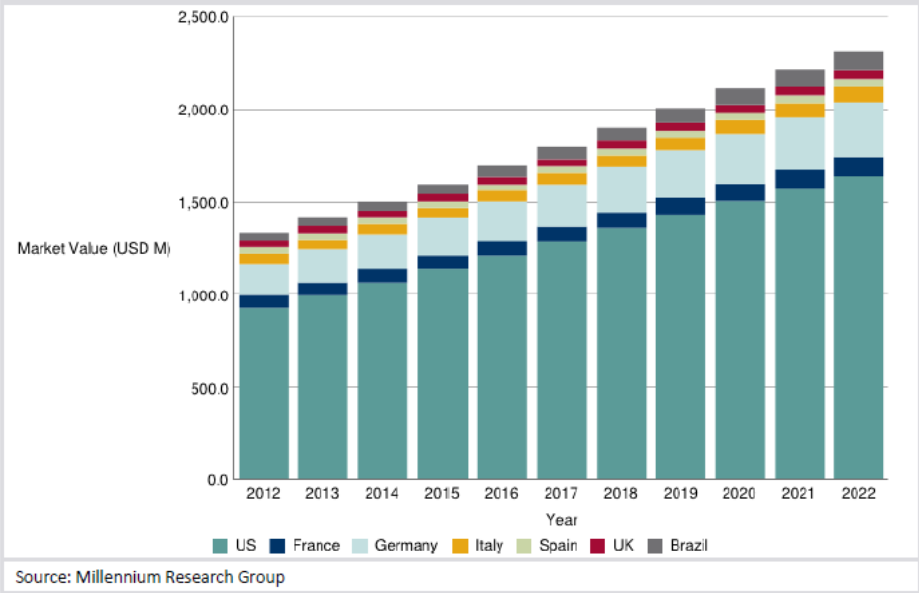
The study compared VELscope to assessment under normal lighting to determine the surgical margins. The respective margins determined by normal light and by VELscope were marked with a surgical pen. 122 oral mucosa biopsies were obtained from 20 surgical specimens (20 from the clinically apparent tumors, 36 from the margins determined to be abnormal by VELscope, and 66 from margins determined to be healthy by VELscope). Results showed that 32 of the 36 abnormal identified margins did indeed show histological changes (7 squamous

cell carcinoma, 10 severe dysplasia, and 15 mild-to-moderate dysplasia). Meanwhile 65 of the 66 healthy identified margins were indeed normal with one showing mild-to-moderate dysplasia. Of the 20 clinically apparent tumors, 19 had abnormal margins that extended beyond what was clinically apparent (i.e. apparent under normal light). In addition, the investigators found that if a conventional 10mm clearance of the clinical tumor had been used, 50% of the tumors in the study would have had cancer or dysplasia at the margin, 30% of which showed severe dysplasia or carcinoma in situ (i.e. abnormal cells that may become cancer).

Dr. Poh notes in the January 26, 2016 press release that they are now working with head and neck surgeons in Canada to conduct a larger surgical margin study. The JAMA article also notes that "An ongoing multicenter, phase 3, randomized surgical trial has completed accrual, and the data will be used to validate the results of this study." If and when a larger, randomized trial completes – and assuming positive results, this potentially could eventually lead to broader indications for VELscope and open it up to an additional and sizeable market.

LED Exploiting Growth in Dental Digital Imaging

Market research supports LED's view of a changing landscape in dental imaging, specifically an ongoing shift to greater demand for digital imaging. The U.S., LED's major focus, is also where the bulk the opportunity lies as it is the largest dental imaging market and is expected to grow from $991M in 2012 to $1.6B in 2022 (per Millennium Research Group).



CBCT Fastest Growing Dental Imaging Modality, LED Riding the Wave…

Cone beam computed tomography, or CBCT, are extraoral (i.e. - outside the mouth) scanners which rotate around the head during an exam, providing a 360^0 view and with 3D images. Extraoral imaging is used to examine both the teeth and bones of the face and jaw, largely for the purposes of implantology (i.e. - assessment and planning of dental implants) and orthodontics. CBCT's ability to provide 3D images is viewed as a significant advantage to the 2D images provided by conventional extraoral imaging modalities. Unlike 2D X-rays, 3D imaging provides the benefit of viewing adjacent and anomalous structures which provides better accuracy and allows for improved visualization and treatment planning, particularly for more complex diagnoses.

A paper published in the October 2010 issue of The Journal of The American Dental Association titled *Practical Applications of Cone-Beam Computed Tomography in Orthodontics*[1] cites several advantages of CBTC over conventional 2D imaging in orthodontics which provide for improved diagnosis and planning. And relative to utility in implantology, in June 2012 the American Academy of Oral and Maxillofacial Radiology updated their guidelines for dental implant imaging, recommending CBCT as the preferred method for presurgical assessment of dental implant sites.

[1] Mah JK., et al. Practical Applications of Cone-Beam Computed Tomography in Orthodontics. JADA, OCt 2010 141,7S-13S

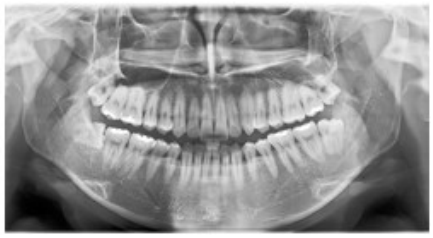
In September 2013 Millennium Research Group published a research study on dental imaging industry trends titled G*lobal Markets for Dental Imaging Systems 2014*. The authors expect growth in the dental implant market and increasing demand for higher quality images will drive future sales of CBCT systems, which they predict will expand at a CAGR of approximately 15% globally and 16% in the U.S. over the ten year period of 2012 - 2022. The report further notes that CBCT is the fastest growing segment in dental imaging and is expected to continue to be so as dental professionals

LED began to capitalize on the expected significant growth in demand for CBCT systems in 2014 when the entered an agreement with Ray Co, Ltd, a former subsidiary of Samsung, to sell that company's RAYSCAN-Expert CBCT instrument in North America. And with roughly 60% of all CBCT systems residing in the U.S., the domestic market is where the lion's share of the business is.

***RAYSCAN - Expert* and Sample Images** *(SOURCE: rayscanamerica.com)*







Film-Based Imaging Being Replaced By Digital Imaging…

According to the 2013 Millennium Research Group report the global market for dental imaging will grow from $1.4B in 2012 to $2.3B in 2022, a CAGR of 5.5% which will be driven in part by the transition of film-based to digital-based imaging. Other factors also expected to facilitate this growth are greater demand for technologies that can increase patient flow (which also relates to the switch from film to digital imaging) as well as growing popularity of cosmetic dentistry procedures, such as veneers and orthodontics.

Intraoral imaging is used for the detection of cavities, to look at the roots of the tooth and to evaluate the health of area around tooth. There are two types of digital intraoral imaging systems; photostimulable phosphor plate systems (PSP plate systems) and digital X-ray sensors. PSP plate systems are indirect and involves a small plate (that is used in place of film) that is inserted into the mouth and then removed and digitally scanned. Digital sensors are direct, meaning that the sensor sends the data directly to a computer. PSP plate systems are more economical in terms of upfront costs but have disadvantages to digital sensors including that while sensors provide immediate results, scanning time with PSP plate systems can take up to two minutes.

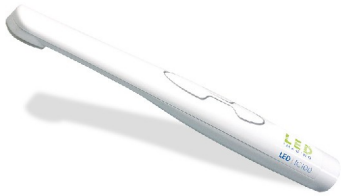
Millennium Research expects film based modalities to be replaced by digital systems and for PSP plate systems to increase at a CAGR of about 2.6% in the U.S. over the next ten years. However, as practitioners are increasingly demanding improved workflow and patient throughput, the minutes lost waiting for scanning via PSP will drive even greater interest in digital X-ray sensors. Another advantage of digital X-ray sensors is their easy integration with electronic medical record systems. Millennium expects these advantages to push the U.S. digital X-ray sensor market up at a CAGR of about 4.4% over the next ten years.

LED is also participating in this market. In May 2014 the company announced the introduction of LED IS100, a digital intraoral sensor, which the company is distributing in the U.S. The sensor is manufactured by Owandy, a France-based digital imaging company which has a presence in Europe but insignificant sales in the U.S., providing LED with a wide-open opportunity to exploit the domestic market. LED also introduced two intraoral cameras, IC100 and IC200.

Intraoral Sensor

IC100 Intraoral Camera *(SOURCE: leddental.com)*





Ray Co.and LED Dental expect a fairly regular flow of new product introductions and in April 2015 launched RIOSensor Digital Radiography System.

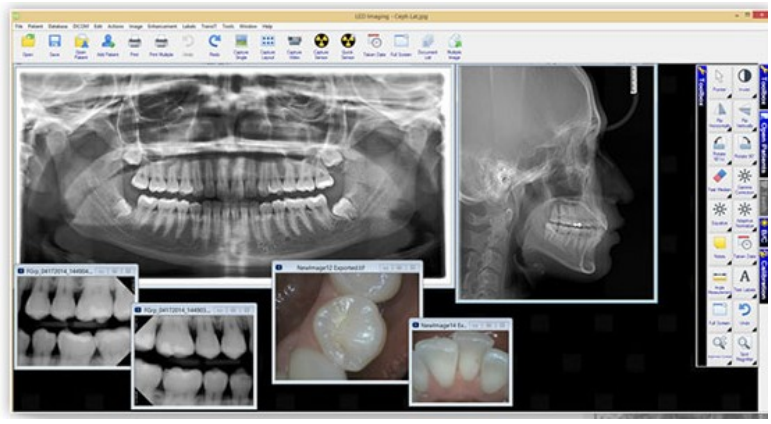


Then in March 2016 they announced that their new Tuxedo digital intraoral radiography system received FDA 510(k) clearance, allowing it to be sold in the U.S. Tuxedo is as billed as providing some of the highest image quality of any intraoral sensors on the market.

Imaging Software Ties In Intraoral / Extraoral Imaging

Imaging software is used to generate and store the images produced by intra- and extra-oral imaging modalities. In April 2014 LED announced the launch of open-architecture imaging software. The software is compatible not only with RAYSCAN-Expert but also with intraoral and extraoral devices from a variety of manufacturers. It also can be seamlessly integrated with any dental practice management suite.

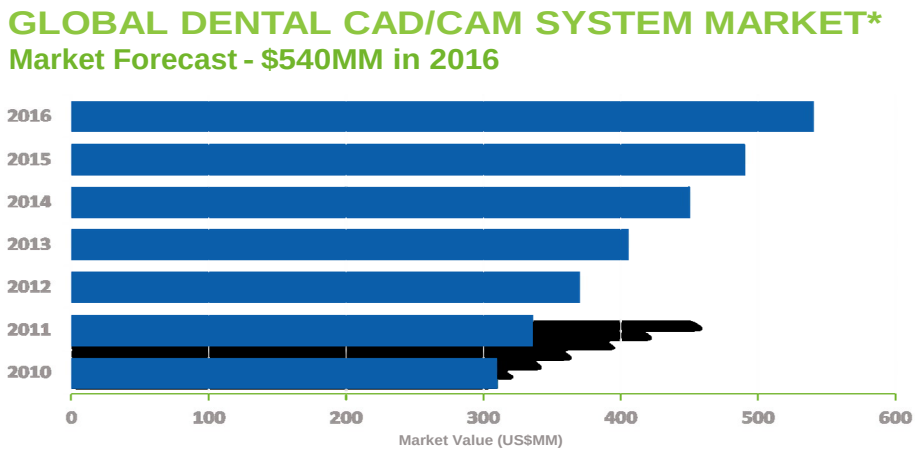
LED Imaging Software *(SOURCE: leddental.com)*



And as a complement to their software, April 2015 LED announced the launch of "LED Imaging Cloud" which provides dentists secure and easily accessible cloud storage of patient records and clinical data. Similar to personal and business computing, onsite data storage of medical and dental records via hard drives and servers

is undergoing a rapid and massive shift to the cloud given the benefits of ease of access from any location, security and greater capacity. LED Imaging Cloud is compatible with both 2D and 3D data, allows for housing of all patient records on all workstations in one location and can be integrated with most imaging systems.

Software is a key piece in patient diagnosis and treatment planning. It is also used for computer-aided design/computer-aided manufacturing (CAD/CAM), a rapidly growing area in dentistry. CAD/CAM is used to design dental restorations such as veneers, crowns and prostheses but is still considered to be in the early adoption phase, leaving significant room for growth. Millennium Research expects the global CAD/CAM market to grow from approximately $320M in 2010 to $540M in 2016 (9% CAGR).



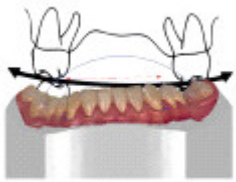
SOURCE: Millennium Research Group

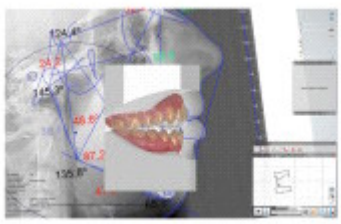
And LED made even more recent additions to its product portfolio, building on its quest to become a one-stop shop for dental imaging and related products and a full-product provider for practices converting from film to digital imaging.

In mid-June 2015 the company announced that they will begin distribution of 3Shape's 3D intraoral digital impression and desktop scanner to the orthodontic market. The TRIOS 3 digital impressioning system further beefs up the company's burgeoning digital imaging product portfolio and provides more headway towards exploiting the high potential opportunity in the orthodontics space which has seen growing demand for higher quality imaging.

3Shape Trios Scanner and sample images







In August LED penned an agreement with EnvisionTec to distribute that company's EnvisionTec 3D printers. The printers are used by dental and orthodontic practitioners and laboratories to make a variety of implants, materials

and tools including crowns, bridges, models, surgical guides and other dental and orthodontic products. The addition of a 3D printer to LED's product portfolio further enhances their ability to be a one-stop for dental imaging and related products and a full-product provider for practices converting from film to digital imaging. And with 3D being one the fastest growing segments in dental and orthodontics, their burgeoning product portfolio continues to strengthen their position to leverage one of the most attractive areas in the industry.

EnvisionTec 3D Printer



LED Making Rapid Progress in Tapping Imaging Market

The company has already made significant strides in tapping the digital imaging market since LED Imaging was formed in April 2014. They have signed partnership deals to distribute high potential digital imaging products throughout North America and commenced building a sales infrastructure to promote the products. LED is also in a somewhat unique and advantageous position in terms of distribution as they can leverage their already established VELscope customer base, which currently stands at approximately 13k dental practices.

And while the company has already brought several third-party digital imaging products under its distribution umbrella, management has indicated that they remain highly engaged with existing and other potential new partners with an eye on further expanding their dental imaging and technology product suite and expect their LED Imaging business to be a major driver of long-term growth of the company.

This early progress has already culminated in a significant increase in orders and revenue. Revenue grew 256% to $9.0M in 2014 and another 47% in 2015 to $13.1M. We currently model $14.2M in revenue for 2016, implying growth of 9% from 2015.

VELscope Also Remains a Focus

And while LED has dedicated considerable energy on building its imaging division, reviving sales of the company's proprietary oral cancer screening device, VELscope, also remains a priority. VELscope continues to hold the title of the world's leading adjunctive screening device for oral tissue abnormalities, including oral cancer. There are currently about 13k devices in use. But despite success in building a sizeable installed base, VELscope sales have recently lagged. Revenue fell from $6.3M in 2012 to $2.5M in 2013 in the midst of a change in distribution model (more recent figures have not been disclosed).

Since then the new management team has implemented changes related to VELscope distribution and optimized sales and marketing. This has included changing their distribution - from one which was heavily reliant on a single distributor to one which now will include several sales organizations. LED has made considerable progress

in this regard. Since late 2013, the company has penned new distribution agreements with eight distributors including "majors" Patterson Dental, Henry Schein and DenMat Holdings. Optimization of the distribution model along with additional clinical evidence supporting the use of VELscope for oral cancer detection (including the recently published surgical margin data), is expected to culminate in additional growth in sales of the device.

And LED has recently begun looking at more “ways to expand adoption and the user base". This included partnering with the Oral Cancer Foundation in that organization’s recent initiative to promote more oral cancer screening. Under the relationship, LED provides a VELscope free of charge to dental practices that agree to perform at least three daily oral screenings over three years. While LED provides the instrument at no cost, they will charge the practices for the single-use consumable (i.e. disposable caps), which is where most of the margin is.

While these types of non-traditional marketing initiatives may not result in immediate ROI, they have the potential to broaden the user base over the long-term. And a larger user base is particularly valuable to a company like LED that uses a razor/razor blade revenue model in their VELscope segment which affords the potential for revenue and profitability to exponentially improve with just incremental growth in the installed base.

Beefing Up International Presence…

But much of the opportunity for growth of VELscope may lie outside of the U.S. and management is putting more efforts towards exploiting this. The company recently implemented a strategy to beef-up their overall international VELscope effort given that the ex-U.S. market represents about two-thirds of the total market opportunity. VELscope VX received regulatory approval in China in August 2015 and in June 2016 LED announced British Columbia-based Biocare Health Supply will be exclusive distributor of VELscope Vx in China and Hong Kong. Biocare has teamed with National Medicines Prospect Dentech Co of Beijing, which the press release notes as being the largest dental equipment distributor in China. Initial sales are expected to begin in August of this year.

We expect LED will look to gain marketing approval in other international territories, particularly spots in Europe and Asia. Following gaining requisite regulatory approvals, the next step will be to consummate distribution agreements in those regions of the world. While we model only incremental progress on this front in 2016 (given that regulatory approvals, in particular, can be a several-quarter process), we think next year may see additional and more significant contribution from growth in international VELscope sales.

OUTLOOK / VALUATION

Revenue fell 60% in 2013 but has since done an about-face, increasing 256% in 2014 and another 47% in 2015. We think it is now clear that the initial portion of the company's shift in strategy, which includes a major focus on expanding distribution and complementary revenue opportunities, has already been well established - and has been done in much more rapid fashion than we had initially anticipated it would be. The architects, namely David Gane and Lamar Roberts who came to LED from Carestream with highly relevant experience in the dental products industry sales, have made obvious substantive progress (in a very short period of time) with broadening the distribution footprint, revamping the sales strategy, growing the product portfolio and returning the company to positive revenue growth.

Expansion of the product suite has ramped very rapidly and, along with a change in distribution model, has been the work of the new management team. This recent shift in strategy appears to already be the turning point for the company in terms of returning it to positive revenue growth.

We expect moderate growth of the VELscope installed system base in the U.S. and accelerating growth in international markets. While we think the U.S. market remains the largest base for LED and at less than 10% penetrated, still provides significant upside for the company, international markets, which are almost completely untapped, offer potentially steep growth curve opportunities over the next several years. We expect LED will look to gain marketing approval in other international territories, particularly spots in Europe and Asia. Following gaining requisite regulatory approvals, the next step will be to consummate distribution agreements in those regions of the world. While we model only incremental progress on this front in 2016 (given that regulatory approvals, in particular, can be a several-quarter process), we think next year may see additional and more significant contribution from growth in international VELscope sales.

Meanwhile, the company will further capitalize on their distribution reach and leverage their sales infrastructure through a larger product portfolio. The RAYSCAN agreement already looks like a winner for LED and the company expects to continue to look to add complementary products to their sales forces' bags. Per our discussions with management relative to the potential of the LED Imaging business, this segment holds great opportunity to grow over the long-term. This outlook appears to be supported by industry research indicating attractive growth on the horizon for digital dental imaging equipment and technology.

We value LED using a 10-year discounted cash flow model. We have revenue CAGR of about 22% from 2015 through 2019, then dropping to a low-double digit average through 2025. We also note that growth in the LED Imaging business could outpace our current estimates - these will also be subject to updating as the potential for these products becomes more clear. This could provide revenue upside to our model, particularly over the mid-to-long-term time frames. We use a 10% discount rate and 2% terminal growth rate. Based on DCF, LED is value at approximately $0.90/share.

FINANCIAL MODEL

LED Medical Inc.

	2015 A	Q1A	Q2A	Q3E	Q4E	2016 E	2017 E	2018 E	2019 E
Revenue	$13,135	$2,153	$3,661	$2,321	$6,147	$14,283	$18,914	$25,882	$29,380
YOY Growth	*46.6%*	*-11.8%*	*12.0%*	*30.2%*	*9.0%*	*8.7%*	*32.4%*	*36.8%*	*13.5%*
Cost of sales	$9,561	$1,618	$2,590	$1,562	$4,228	$9,998	$12,114	$15,864	$17,645
Gross Income	$3,573	$536	$1,071	$759	$1,919	$4,285	$6,801	$10,018	$11,735
Total Gross Margin	*27.2%*	*24.9%*	*29.3%*	*32.7%*	*31.2%*	*30.0%*	*36.0%*	*38.7%*	*39.9%*
SG&A	$8,584	$2,480	$2,063	$1,973	$2,809	$9,325	$10,932	$12,967	$14,044
% SG&A	*65.4%*	*115.2%*	*56.3%*	*85.0%*	*45.7%*	*65.3%*	*57.8%*	*50.1%*	*47.8%*
R&D	$189	$50	$20	$58	$82	$210	$530	$611	$710
% R&D	*1.4%*	*2.3%*	*0.5%*	*2.5%*	*1.3%*	*1.5%*	*2.8%*	*2.4%*	*2.4%*
Operating Income	($5,200)	($1,995)	($1,011)	($1,272)	($972)	($5,250)	($4,662)	($3,560)	($3,019)
Operating Margin	*-39.6%*	*-92.6%*	*-27.6%*	*-54.8%*	*-15.8%*	*-36.8%*	*-24.6%*	*-13.8%*	*-10.3%*
Total Other Income	$20	($57)	($71)	($50)	($33)	($211)	$55	$61	$14
Pre-Tax Income	($5,180)	($2,052)	($1,083)	($1,322)	($1,005)	($5,462)	($4,607)	($3,499)	($3,005)
Taxes (benefit)	($4.1)	$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	($5,176)	($2,052)	($1,083)	($1,322)	($1,005)	($5,462)	($4,607)	($3,499)	($3,005)
Net Margin	*-39.4%*	*-95.3%*	*-29.6%*	*-57.0%*	*-16.3%*	*-38.2%*	*-24.4%*	*-13.5%*	*-10.2%*
EPS	($0.05)	($0.02)	($0.01)	($0.01)	($0.01)	($0.05)	($0.03)	($0.02)	($0.02)
YOY Growth	*-33.9%*	*13.6%*	*-20.3%*	*-13.8%*	*-15.5%*	*-6.5%*	*-34.9%*	*-26.0%*	*-17.9%*
Diluted Shares O/S	101,208	112,319	112,514	113,000	119,000	114,208	148,000	152,000	159,000

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