Zacks Small-Cap Research

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iCAD Inc

(ICAD-NASDAQ)

ICAD: Q2 Results Much More Solid Than Numbers Suggest. U.S. Tomo Launch Encouraging

Based on average EV/S and P/S multiples of five comparable companies, iCAD is valued at approximately $7.50/share.

Current Price (08/16/17)	$3.67
Valuation	**$7.50**

OUTLOOK

While Q2 revenue fell 13% yoy, we actually characterize results as relatively strong based on the sizeable beat to our estimate and the details within the numbers. More encouraging, however, was commentary on the conference call (which we missed due a timing conflict) indicating that the U.S. 3D tomo launch is off to a strong start and only expected to accelerate. And while the Therapy segment has taken much longer than expected to gain much traction, we continue to believe there are substantive signs that this business is finally beginning to turn a corner. In summary, we would be very surprised if Q2 revenue, of $6.4M, does not represent a valley and regular sequential growth does not return in Q3.

SUMMARY DATA

52-Week High	**$6.29**
52-Week Low	**$2.85**
One-Year Return (%)	**-30.06**
Beta	**1.52**
Average Daily Volume (sh)	**25,500**
Shares Outstanding (mil)	**17**
Market Capitalization ($mil)	**$63**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**25**
Insider Ownership (%)	**19**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-0.5**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2017 Estimate	**N/A**
P/E using 2018 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**Average,**
Type of Stock	**Small-Blend**
Industry	**Comp-Software**

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2016	6038 A	7369 A	6003 A	6928 A	26338 A
2017	6791 A	6409 A	6998 E	7580 E	27778 E
2018					39194 E
2019					50038 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2016	-$0.16 A	-$0.10 A	-$0.17 A	-$0.20 A	-$0.63 A
2017	-$0.18 A	-$0.16 A	-$0.15 E	-$0.14 E	-$0.48 E
2018					-$0.30 E
2019					$0.03 E

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

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Q2 2017 Results: Results Much More Solid Than Numbers Suggest. U.S. Tomo Launch Encouraging...

iCAD reported results for their second quarter ending June 30th. While revenue fell 13% yoy, we actually characterize results as relatively strong based on the sizeable beat to our estimate and the details within the numbers. More encouraging, however, was commentary on the conference call (which we missed due a timing conflict) indicating that the U.S. 3D tomo launch is off to a strong start and only expected to accelerate. And while the Therapy segment has taken much longer than expected to gain much traction, we continue to believe there are substantive signs that this business is finally beginning to turn a corner. In summary, we would be very surprised if Q2 revenue, of $6.4M, does not represent a valley and regular sequential growth does not return in Q3.

Total Revenue: $6.4M (vs. $6.0M estimate) down 13% yoy, down 6% sequentially

Following the reporting of Q1 results in May, which handily beat our topline estimate, we made some downward revenue revisions to our Q2 revenue number given what we thought might have been some favorable order timing (in Detection) in the prior period and which might negatively impact Q2. That doesn't seem to have been the case - which we think is one of potentially several signs that the 3D tomo roll-out (now launched in Europe and U.S.) is quickly gaining traction.

Relative to our estimates, Q2 Detection revenue was about 15% better which more than offset an 8% miss in Therapy sales - the net result was a 6% beat to our total revenue estimate. And while total revenue was down 13% yoy and 6% from Q1, details behind the numbers paint a better picture. Stripping out MRI revenue, which contributed ~$600k in the prior-year period, means revenue fell just 5% from Q2 2016 and Detection revenue (which on a GAAP basis was down 14%) contracted only about 1%. With early indications of already robust demand for the 3D tomo product - which just launched in the U.S. in March, we think Detection revenue is poised for meaningful acceleration.

And looking at the 6% qoq slide - again, if MRI revenue, which contributed ~$300k in Q1 2017 and $0 in Q2, is removed, total revenue also contracted by only 1% sequentially, while Detection revenue actually eked out 1% growth. Almost all of the $382k sequential decline (pro forma for the MRI assets sale) can be attributed to lumpiness in Therapy product sales - which fell $341k.

The Therapy segment also looks better, in our opinion, then what the Q2 sales numbers suggest. Therapy has pretty much been a dog - and not a particularly cute one - over the previous five consecutive quarters. The reasons are well known and relate mostly to adverse changes to NMSC reimbursement. The five quarters referenced end with Q1 2017 as Q2 Therapy revenue, although down 12% yoy and 5% sequentially, actually appears to suggest this segment may be returning to growth. All of the revenue contraction (for both comparable periods) relates to Xoft system sales - which has been historically and inherently lumpy and, with growth of the subscription-based option, has become a much less significant area of focus. And while only one system was sold in Q2, management noted on the call that they had expected to close several more systems but that those slipped to Q3.

Given that the skin business (particularly subscription sites) is where most of the opportunity for growth lies in this segment, the fact that Therapy services/supplies revenue in Q2 was at the highest level since Q4 2015 is highly encouraging. More encouraging, however, is that both utilization and the number of sites treating appear to continue to be trending higher (the fruits of which are mostly captured in this line item). The number of sites treating has increased from 37 at the close of 2016 to 48 today and management expects this to continue to grow throughout the remainder of 2017. And importantly, the number of treating subscription sites has grown from just 6 to 25 over that same period. In terms of utilization, 12k treatments were performed in Q2 2017 - up from just 7k treatments in Q4 2016.

We note that we had concerns in the past that Therapy services/supplies had essentially flattened for five straight quarters despite metrics suggesting that utilization and the number of active sites was growing. So while one positive quarter does not make a trend, we are hopeful that the potential lag between utilization and related revenue is now showing up in the income statement and continued growth in one will result in continued growth of the other. This will be a line-item of great interest over the next few reporting periods given that it should provide ongoing insight into the relative strength (or weakness) of the recovery of the NMSC business.

Cancer Detection (Q2): $4.2M (vs. $3.7M estimate): -14% (-1% organic) yoy, -6% (+1% organic) sequentially

While Detection product revenue was essentially flat (ex-MRI) from Q1 2017, that in our opinion, was actually an encouraging outcome. As a reminder, Q1 sales benefitted from a robust order flow for the 3D tomo product in

Europe and actually set a new record in terms of international CAD orders. While we expected that might cause some lumpiness (i.e. softness) into Q2, that wasn't the case as initial sales from the 3D tomo launch in the U.S. helped buoy Detection product revenue.

The U.S. launch kicked off in March with ICAD's direct sales force which was followed in June with GE's women's health sales force. Early indications regarding U.S. demand for the product, based on management's comments on the call, are quite encouraging. This includes comments that customer interest is strong, that the sales pipeline increased from $4.5M at the close of Q1 to over $7.5M at the end of Q2 and that sales are gaining significant momentum and expected to increase in Q3.

And this early success is despite facing what might be considered some (slight) headwinds. This includes a higher training/learning curve for the GE sales team given the much greater complexity in reading 3D versus 2D images as well as the fact that (per management's comments) ICAD's product wasn't listed on GE's price list until June. ICAD is actively involved in continuing to train GE reps and with the inclusion on GE's price list, those headwinds should either dissipate or no longer be an issue.

And with ICAD's product included in GE's recently kicked-off, 18-city roadshow, there is already a significant push by their partner to build awareness of the products. GE's plan is to sequentially grow shipments of their Pristina machine each quarter - which certainly indicates they are actively marketing which should complement ICAD's direct efforts in ramping sales of their 3D tomo product.

ICAD's next-generation product provides what may be an even greater opportunity for the company. This product is not only expected to reduce reading time but also further improve on accuracy to the point where radiologists will only need to read abnormal exams. This combination could prove of significant value in reducing reading time and, potentially, reduce staffing needs thereby helping to lower related costs. It is also being developed for use on all manufacturers machines which would massively increase the (low-hanging fruit) upgrade opportunity (ICAD's worldwide mammography installed base is ~5k units). ICAD has previously mentioned that preliminary testing has shown much higher performance then they had initially anticipated. Competitive performance could be key relative to maximizing market share among the various manufacturers' installed bases.

While ICAD had been shooting for development and testing to be completed and have their next-gen product launched in Europe by late 2017 and in the U.S. by mid-2018, those timelines appear to have slipped a little. Per the Q2 call, their updated expectations are for the European roll-out to start in Q1 2018 and for U.S. launch to happen in 2H 2018 - the latter which is contingent on first receiving FDA clearance. Similar to the initial 3D tomo product, U.S. regulatory clearance will be via the PMA pathway and must be supported by a reader study.

Given the swift industry shift from 2D to 3D and wider breadth of machines that this second-gen product has availability for and its enhanced features, introduction of this could result in another, and potentially much steeper, new wave of Detection segment growth. While we had been modeling initial revenue contribution from this product in 1H 2018, we have now delayed that by about six months. This update, however, has had no material effect to our total revenue estimates given the offset from upward revisions to our estimated contribution from the first-gen product as a result of the apparent greater and more rapid adoption as compared to our prior assumptions.

Cancer Therapy (Q2): $2.2M (vs. $2.4M estimate): -12% yoy, -5% sequentially

Despite the revenue contraction versus both comparable periods as well as the 14% miss to our number, we think it was a relatively solid showing for the Therapy segment. Importantly, services/supplies revenue, at $2.06M, was up 12% on both a yoy and sequential basis. It was also the highest since Q4 2015 and 11% better than our estimate. Meanwhile, Therapy product sales, which can swing fairly widely quarter-to-quarter, were just $123k - representing one skin-related system placement. The relative weakness in Therapy product sales - which fell 81% yoy and 73% qoq and were well below our $500k estimate - is much less meaningful in the context of the fundamental health or growth potential of this segment, in our opinion.

As we noted earlier, if the number of NMSC sites treating and utilization continues to grow, as management believes will happen, Therapy services/supplies - which represents the vast majority of growth potential in this segment - should also push higher.

Management has indicated that while there has been a trend in capital customers not renewing source contracts, that at least some of this has been offset by some positive traction on the subscription side. Indications are that this positive trend (i.e. traction on the subscription side) may be accelerating. The (net) number of sites treating has increased from 37 at the close of 2016 to 48 today and management expects this to continue to grow throughout

the remainder of 2017. And importantly, the number of treating subscription sites has grown from just 6 to 25 over that same period. In terms of utilization, 12k treatments were performed in Q2 2017 - up from just 7k treatments in Q4 2016.

And as we indicated, while it is still too early to make any concrete conclusions regarding the strength or sustainability of a recovery of the NMSC business, these recent trends are positive in that regard. And as we have noted in the recent past, while the capital-customer attrition continues to raise the question regarding a "sufficient" level of reimbursement - particularly given that these are customers that would have significant capital at risk – it's clearly a positive sign that procedural volume and the subscription business appears to be firming up.

ICAD indicated that more existing subscription customers are coming back online and that their recently implemented sales efforts towards that end have been bearing fruit. In addition, the company has dedicated resources towards helping their customers bring in NMSC patients. So, assuming procedural volume and the subscription base continue to grow, we would expect to see continued growth of services/supplies revenue.

And we still remain optimistic longer term on NMSC given clinical outcomes supporting use of EBx. Clinical data continues to show excellent outcomes including superior cosmetic results and patient satisfaction as compared to surgery, which should help support the quest for favorable insurance reimbursement. And in the meantime ICAD will pursue a CPT I code granting of which would all but eliminate ambiguity or significant differences in reimbursement policy and values. In November 2015 the company initiated a retrospective study of ~500 patients, results of which they hope to use to support an eventual CPT I code application. While the study will follow patients for five years, they will be able to include patients that completed treatment in 2013.

Additional positive study data, which showed nearly comparable recurrence rates between eBx and (traditional) Mohs surgery at 3+ years follow-up but better cosmetic outcomes among the eBx-treated patients, was recently published in the Journal of Contemporary Brachytherapy. The scope and breadth of the clinical portfolio will likely dictate timing of an eventual submission to CMS of a CPT I application.

In terms of IORT, ICAD's success in building this business has been to drive sales in the U.S. on the back of positive clinical data and to continue to expand internationally. They will continue that strategy, with data from ongoing studies expected to be available in the near term. ICAD's 1,000-patient ExBRT (Safety and Efficacy Study of Intra-Operative Radiation Therapy (IORT) Using the Xoft Axxent eBx System at the Time of Breast Conservation Surgery for Early-Stage Breast Cancer) study recently completed enrollment. Following analysis, ICAD will look to have the data published. The study is being conducted at 20+ sites in the U.S. and Canada and is evaluating safety, efficacy, cosmetic outcomes and quality of life of patients for 10 years post-treatment.

ICAD recently launched an applicator for cervical cancer (GYN) which represents another potential area of growth - early indications suggest growing international demand in this application. Other IORT-related growth initiatives include to continue to expand internationally by gaining regulatory approvals and establishing distribution in more countries throughout the globe. Management noted on the Q2 call that, based on their current sales pipeline, that they expect the second half of the year to be stronger for IORT and GYN related system placements as compared to the first six months of 2017.

Model / Valuation

Model Updates
We have made only incremental updates to our financial model following Q2 results.

We have Therapy revenue growing sequentially throughout the remainder of 2017 and will be particularly interested to see how the services/supplies revenue line trends given the relationship to the fundamental health of the ever-important NMSC subscription business. We also have additional contribution on the products side, which could see a nice uptick in Q3 given the comments related to certain sales slipping past Q2.

Meanwhile, we have Detection revenue growing 6% (updated from 3% growth) - this is not adjusted for the MRI CAD revenue that will not repeat in 2017. And importantly, we show Detection exhibiting relatively very strong growth on both a yoy and sequential basis starting in Q3 '17 – which, again, is largely attributable to expected substantive revenue from tomo in the U.S. and additional gains overseas.

ICAD was quick to cut costs following revelation of the NMSC reimbursement change. While they have recently added some sales personnel to help facilitate uptake and utilization in NMSC, we expect the company will be diligent on cost control.

Pro forma for the $2.5M gain on sale of MRI assets (in Q1), we model 2017 EPS of ($0.63), revised from ($0.67).

Valuation
We value iCAD based on competitor price/sales (P/S) and enterprise value /sales (EV/S) multiples. Using analyst's revenue estimates for the years 2017 and 2018, we calculated P/S and EV/S ratios from imaging (HOLX) as well as surgical (VAR, ISR, EKTAF, SRTS) companies. These companies currently trade at an average P/S-2017 of 3.8x and P/S-2018 of 3.0x and average EV/S-2017 of 3.7x and EV/S-2018 of 3.0x.

Based on the average of the EV/S and P/S multiples iCAD is valued approximately $7.50/share.

FINANCIAL MODEL

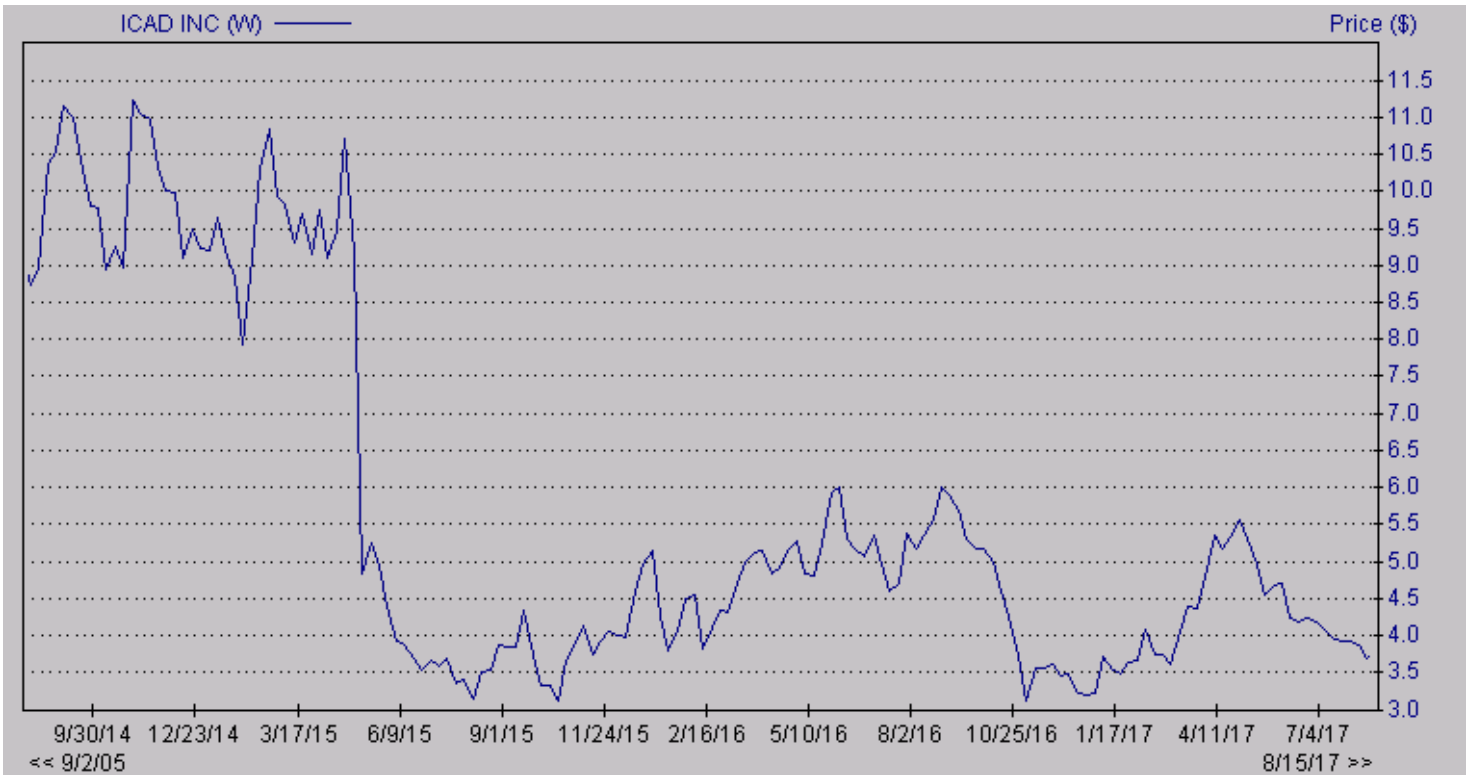
iCAD Inc.

	2016 A	Q1A	Q2A	Q3E	Q4E	2017 E	2018 E	2019 E
Cancer Detection	$17,133.0	$4,489.0	$4,231.0	$4,560.8	$4,931.9	$18,212.7	$27,669.8	$36,033.7
YOY Growth	*-11.0%*	*14.2%*	*-13.6%*	*10.3%*	*18.2%*	*6.3%*	*51.9%*	*30.2%*
% of total revenue	*65.1%*	*66.1%*	*66.0%*	*65.2%*	*65.1%*	*65.6%*	*70.6%*	*72.0%*
Therapy	$9,205.0	$2,302.0	$2,178.0	$2,437.0	$2,648.0	$9,565.0	$11,524.0	$14,005.0
YOY Growth	*-58.7%*	*9.2%*	*-11.9%*	*30.4%*	*-3.9%*	*3.9%*	*20.5%*	*21.5%*
% of total revenue	*34.9%*	*33.9%*	*34.0%*	*34.8%*	*34.9%*	*34.4%*	*29.4%*	*28.0%*
Total Revenues	$26,338.0	$6,791.0	$6,409.0	$6,997.8	$7,579.9	$27,777.7	$39,193.8	$50,038.7
YOY Growth	*-36.6%*	*12.5%*	*-13.0%*	*16.6%*	*9.4%*	*5.5%*	*41.1%*	*27.7%*
Cost of Revenues	$7,820.0	$2,102.0	$1,906.0	$2,028.4	$2,194.6	$8,231.0	$10,375.2	$12,882.1
Gross Income	$18,518.0	$4,689.0	$4,503.0	$4,969.4	$5,385.3	$19,546.7	$28,818.6	$37,156.6
Gross Margin	*70.3%*	*69.0%*	*70.3%*	*71.0%*	*71.0%*	*70.4%*	*73.5%*	*74.5%*
R&D	$9,518.0	$2,574.0	$2,232.0	$2,284.0	$2,414.0	$9,504.0	$9,784.0	$10,101.0
% R&D	*36.1%*	*37.9%*	*34.8%*	*32.6%*	*31.8%*	*34.2%*	*25.0%*	*20.2%*
Selling & Mktg	$10,179.0	$2,902.0	$2,690.0	$2,904.1	$2,910.7	$11,406.8	$13,090.7	$14,461.2
% Sell&Mktg	*38.6%*	*42.7%*	*42.0%*	*41.5%*	*38.4%*	*41.1%*	*33.4%*	*28.9%*
G&A	$8,791.0	$2,156.0	$2,205.0	$2,260.0	$2,351.0	$8,972.0	$10,864.0	$11,744.0
% G&A	*33.4%*	*31.7%*	*34.4%*	*32.3%*	*31.0%*	*32.3%*	*27.7%*	*23.5%*
Operating Income	($9,970.0)	($2,943.0)	($2,624.0)	($2,478.7)	($2,290.4)	($10,336.1)	($4,920.1)	$850.4
Operating Margin	*-37.9%*	*-43.3%*	*-40.9%*	*-35.4%*	*-30.2%*	*-37.2%*	*-12.6%*	*1.7%*
Other income	$9.0	$2,508.0	$0.0	$0.0	$0.0	$2,508.0	$0.0	$0.0
Other Interest income, net	($62.0)	($5.0)	($10.0)	($2.0)	($8.0)	($25.0)	$22.0	$38.0
Pre-Tax Income	($10,023.0)	($440.0)	($2,634.0)	($2,541.4)	($2,365.9)	($7,853.1)	($5,235.6)	$483.4
Taxes	$76.0	$17.0	($3.0)	$20.3	$18.9	$53.3	$0.0	$0.0
Tax Rate	*-0.8%*	*-3.9%*	*0.1%*	*-0.8%*	*-0.8%*	*-0.7%*	*0.0%*	*0.0%*
Net Income	($10,099.0)	($457.0)	($2,631.0)	($2,561.8)	($2,384.8)	($7,906.4)	($5,235.6)	$483.4
YOY Growth	*69.0%*	*82.0%*	*-67.0%*	*4.2%*	*28.1%*	*21.7%*	*33.8%*	*109.2%*
Net Margin	*-38.3%*	*-6.7%*	*-41.1%*	*-36.6%*	*-31.5%*	*-28.5%*	*-13.4%*	*1.0%*
EPS	($0.63)	($0.03)	($0.16)	($0.15)	($0.14)	($0.48)	($0.30)	$0.03
YOY Growth	*69.5%*	*82.3%*	*-62.9%*	*7.9%*	*30.6%*	*24.0%*	*37.7%*	*109.1%*
Pro-forma adjustments	$0.0	($2,508.0)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pro-forma EPS	($0.63)	($0.18)	($0.16)	($0.15)	($0.14)	($0.64)	($0.30)	$0.03
Diluted Shares O/S	15,975	16,135	16,310	16,600	16,800	16,461	17,500	17,800

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