Zacks Small-Cap Research

February 17, 2017

Brian Marckx, CFA
bmarckx@zacks.com
Ph (312) 265-9474

scr.zacks.com

10 S. Riverside Plaza, Chicago, IL 60606

LED Medical Diagnostics (V.LMD)

V.LMD: Apteryx Looks To Be A Great Fit For LED

Our $0.70 target price and valuation is under review and, along with our model, will be updated after LED files historicals for the pro forma combination of LED Medical and Apteryx – which is expected to occur within the next 90 days.

Current Price (02/17/2017)	$0.08
Valuation	**$0.70**

OUTLOOK

We think LED's acquisition of Apteryx may be an exception to many micro-cap M&A transactions in that product and operational fit were carefully (and wisely) and appropriately balanced. And the fact that there has been a long courtship between the two parties prior to consummation of the marriage should lend itself to mitigation of any relationship or personality-related risks. So while we will wait to opine on the potential financial impact and influence on LED's valuation until after the pro forma historicals are filed, we are encouraged by what we think appears to be the makings of an operationally healthy and (hopefully) financially beneficial transaction.

Our model has not been updated to reflect contribution from Apteryx nor for the equity and debt raises commensurate with the acquisition. We will incorporate Apteryx into our model following LED's filing of pro formas – which we expect will happen within the next 90 days. Our model updates could also influence our valuation of LED Medical.

SUMMARY DATA

52-Week High	**$0.19**
52-Week Low	**$0.05**
One-Year Return (%)	**-47**
Beta	**0.15**
Average Daily Volume (sh)	**261,479**
Shares Outstanding (mil)	**113**
Market Capitalization ($mil)	**9**
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 2017 Estimate	**N/A**
P/E using 2018 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	$2489 A	$5335 E	$13638 E
2017					$16955 E
2018					$21438 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 A	-$0.01 E	-$0.04 E
2017					-$0.03 E
2018					-$0.02 E

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

© Copyright 2017, Zacks Investment Research. All Rights Reserved.

Apteryx Brings Diversified/Synergistic Portfolio, IP, Expanded Customer Base and Profitability

In September 2015 LED Medical announced their intent to acquire "100% of a growing and profitable technology company to complement LED's existing business and provide a platform to assist LED in achieving its strategic and long-term business objectives." The press release further noted that, "The potential transaction, if successfully negotiated and closed, would be significantly additive to revenues, and immediately accretive to EBITDA and net earnings and bring additional Intellectual Property to the Company."

LED mentioned little after that regarding the potential acquisition until this January when they announced their intent to acquire Apteryx, Inc., an Ohio-based company which develops and sells software primarily for the dental industry. The deal closed earlier this week.

Apteryx looks like it could be a great fit for LED given that there appears to be some potential significant synergies among the companies' product portfolios and customer call points. Apteryx brings the dental imaging and database software that supports LED's digital imaging hardware – providing a one-stop-shop for dental practices. Apteryx's software licensing and recurring revenue business model will also provide welcome diversity and smoothing to LED's capital product sale revenue stream – which is typically highly seasonal and based on the dental industry's capex purchasing patterns.

And beyond the current benefits, which apparently also includes profitable operations, Apteryx brings a sizeable patent portfolio and software development experience which can be expected to be leveraged for future growth including from further expansion of their product offerings.

Terms:

- $10.25M acquisition price for 100% of Apteryx:
    - $7M cash at closing
    - $1.8M (33.9M shares @ C$0.07, ~$0.53) worth of LED stock at closing
    - $1.2M cash paid in tranches over 18 months
    - $450k in cash or LED stock (LED's option) in 24 months
- Apteryx will operate as a stand-alone subsidiary of LED
- Apteryx's founder and CEO, Kevin Crucs, will continue to run operations and joins LED's management team

Concurrent financing:

Concurrent with the acquisition LED raised approximately $11.1M (~C$14.4M) via the sale of equity and debt. Equity raise (~$10.2M) includes the sale of approximately 222M common shares (@ C$0.06/share) with 50% warrant (24mths, C$0.10 strike) coverage. Insiders of LED, including directors and officers, bought 9.2M of the shares sold. Debt raise via the sale of ~$886k senior secured debentures (24mths, 12%) with ~2.4M common shares attached.

We estimate that net proceeds after issuance and IB expenses was approximately $10.3M (U.S.) which, after the upfront cash payment to Apteryx, leaves LED with approximately $3.3M. LED also had $342k cash balance at Q3 quarter-end and subsequently raised an additional C$500k via the sale of senior secured debt.

LED's recent quarterly cash burn has averaged ~$800k but with the addition of Apteryx's operations, which LED indicates generates positive cash flow, this level of cash burn could come down. And while LED will also pay an additional $1.2M cash to Apteryx over the next 18 months, we think their cash balance could represent a fairly lengthy runway to fund operations. We will know much more about Apteryx's financials, including cash flow, when LED files historicals for the pro forma combination of the companies in the coming months.

Apteryx

Apteryx, located in Akron, Ohio, was founded in 1995 by Kevin Crucs. The company develops software primarily for the dental and medical imaging markets. The company's competitive positioning includes development of custom software applications to meet the needs of their customers and to do so in a relatively short turnaround time. Per the company's website, "Apteryx specializes in image processing; synthetic imaging and generation; data and image compression; encryption and data security; neural networking; check processing systems, network and communication applications and services; tools and utility applications and services; real-time video imaging; hardware and peripheral integration; proficient in several programming languages for a number of different hardware platforms; design and implementation of several networking and distributed systems applications for inventory management and other large-scale programs; large-scale software projects."

Apteryx 's Product Portfolio: Their products are sold through resellers (such as LED Medical) as well as through their own website. Their suite of products are compatible with hardware of many different manufacturers and designed for businesses of all sizes - from small, single-office practices to large, multi-office organizations. The following product descriptions are from Apteryx's website (www.apteryx.com):

- **XrayVision**: was first launched in 1996 and has become the industry's leading open-architecture digital image management program. XrayVision will capture, enhance and display all of your dental images. Supporting image capture from the majority of the different digital intraoral sensors available today, XrayVision also integrates with phosphor plate scanners, digital panoramic and cephalometric imaging, flatbed scanners, intra-oral and extra-oral cameras, 3D conebeam tomography and many other digital sources.
- **XVWeb**: In addition to being a web application used to view the images, XVWeb is a fully-functional DICOM server that can accept images from any DICOM-compliant imaging software. Although any DICOM-enabled application can be utilized, Apteryx DCV and XrayVision4 are specifically designed to work seamlessly with XVWeb.



- **XVlite**: XVlite will capture, enhance and display all of your dental images. XVlite supports image capture from a majority of the different digital hardware in today's market. XVlite incorporates the latest advancements in imaging technology and Apteryx's patented STB (Secure Tagged Block) file format, an unmodifiable, secure and "loss-less" imaging format. XVlite also exports to a number of common image file formats, including TIFF, JPEG, and BMP for universal viewing.
- **XrayVision DCV**: XrayVision DICOM Capture View, known as DCV, is a DICOM-based dental imaging suite that is scalable to any size organization. DCV is used to standardize the capture, storage, retrieval, and viewing of images across an entire organization. DCV supports most all imaging devices utilized in dentistry, including: Intra-oral sensors, Phosphor Plate Scanners, Panoramic / Cephalometric units, 3D / CAT scan, Tomography, Intra-oral Cameras, Extra-oral Cameras, Endo scopes, and Flatbed Scanners. DCV can act as a full enterprise standalone PACS or can serve as the capture modality that will automatically forward to an existing PACS. DCV's open architecture enables the freedom to use a wide variety of capture devices, while maintaining the industry standards. The US Army and US Navy currently use DCV as their global solution for managing all of their dental clinics worldwide, which allows for centralized storage of all images to provide global access to patient information. XrayVision DCV has numerous bridging capabilities from a standard command line integration, data extraction and auto importing patient demographic, barcode scanning, DICOM Worklist, HL7, and custom data bridges.

Highlights of Apteryx Acquisition:

- Immediately accretive: expected to be significantly accretive to revenue, EBITDA and net income in 2017
- Software margins: while LED has yet to provide specifics, software margins are typically significant and we would expect the Apteryx margins to be substantially better than LED's current ~40%
- Recurring revenue: software licensing and recurring revenue business model provides diversity and smoothing to LED's capital product sale revenue stream which is typically highly seasonal
- One-stop-shop: LED can now provide a full digital imaging product solution, including software and hardware
- Synergies: complementary products which share similar customer call points should provide operational synergies
- Familiarity: the companies' management have known each other for ~15 years and LED is a customer of Apteryx's products. The long affiliation provides for operational and relationship related risk-mitigation, particularly given that Kevin Crucs joins as part of LED's management team
- Expands customer base: immediately bolts on a significantly greater installed base to cross-sell to
- Growth opportunity: Apteryx brings a sizeable patent portfolio (28 patents) and software development experience which can be expected to be leveraged for future growth including from further expansion of their product offerings.

Our comments:
We note that oftentimes M&A transactions in the micro-cap space prove shortsighted given a tendency to overemphasize a goal of product extension and underweight the importance of operational synergies. Operational friction from poor fit often has unfortunate symptoms including bloated (and duplicative) expenses,

lack of unified strategy and direction, and stressed managerial relationships (among others) which is rarely a recipe for success and future growth.

We think LED's acquisition of Apteryx is one of the exceptions where product and operational fit were carefully (and wisely) and appropriately balanced. And the fact that there has been a long courtship between the two parties prior to consummation of the marriage should lend itself to mitigation of any relationship or personality-related risks. So while we will wait to opine on the potential financial impact and influence on LED's valuation until after the pro forma historicals are filed, we are encouraged by what we think appears to be the makings of an operationally healthy and (hopefully) financially beneficial transaction.

Our model has not been updated to reflect contribution from Apteryx nor for the equity and debt raises commensurate with the acquisition. As noted, we will incorporate Apteryx into our model following LED's filing of pro formas – which we expect will happen within the next 90 days. Our model updates could also influence our valuation of LED Medical.

OUTLOOK / VALUATION

Our $0.70 target price and valuation is under review and, along with our model, will be updated after LED files historicals for the pro forma combination of LED Medical and Apteryx – which is expected to occur within the next 90 days.

FINANCIAL MODEL

LED Medical Inc.

Model will be updated for Apteryx acq following filing of historicals for the pro forma combination of LED Medical and Apteryx

	2015 A	Q1A	Q2A	Q3A	Q4E	2016 E	2017 E	2018 E	2019 E
Revenue	$13,135	$2,153	$3,661	$2,489	$5,335	$13,638	$16,955	$21,348	$25,470
YOY Growth	*46.6%*	*-11.8%*	*12.0%*	*39.6%*	*-5.4%*	*3.8%*	*24.3%*	*25.9%*	*19.3%*
Cost of sales	$9,561	$1,618	$2,590	$1,872	$3,806	$9,886	$10,999	$13,207	$15,324
Gross Income	$3,573	$536	$1,071	$617	$1,528	$3,752	$5,957	$8,141	$10,146
Total Gross Margin	*27.2%*	*24.9%*	*29.3%*	*24.8%*	*28.6%*	*27.5%*	*35.1%*	*38.1%*	*39.8%*
SG&A	$8,584	$2,480	$2,063	$1,420	$2,305	$8,268	$9,800	$10,695	$12,175
% SG&A	*65.4%*	*115.2%*	*56.3%*	*57.1%*	*43.2%*	*60.6%*	*57.8%*	*50.1%*	*47.8%*
R&D	$189	$50	$20	$37	$45	$152	$530	$611	$710
% R&D	*1.4%*	*2.3%*	*0.5%*	*1.5%*	*0.8%*	*1.1%*	*3.1%*	*2.9%*	*2.8%*
Operating Income	($5,200)	($1,995)	($1,011)	($840)	($821)	($4,667)	($4,374)	($3,166)	($2,739)
Operating Margin	*-39.6%*	*-92.6%*	*-27.6%*	*-33.7%*	*-15.4%*	*-34.2%*	*-25.8%*	*-14.8%*	*-10.8%*
Total Other Income	$20	($57)	($71)	($16)	($48)	($192)	($175)	($159)	($181)
Pre-Tax Income	($5,180)	($2,052)	($1,083)	($855)	($869)	($4,859)	($4,549)	($3,325)	($2,920)
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)	($855)	($869)	($4,859)	($4,549)	($3,325)	($2,920)
Net Margin	*-39.4%*	*-95.3%*	*-29.6%*	*-34.4%*	*-16.3%*	*-35.6%*	*-26.8%*	*-15.6%*	*-11.5%*
EPS	($0.05)	($0.02)	($0.01)	($0.01)	($0.01)	($0.04)	($0.03)	($0.02)	($0.02)
YOY Growth	*-33.9%*	*13.6%*	*-20.3%*	*-44.1%*	*-24.1%*	*-16.0%*	*-23.9%*	*-31.4%*	*-16.1%*
Diluted Shares O/S	101,208	112,319	112,514	112,787	114,600	113,055	139,000	148,000	155,000

Brian Marckx, CFA

© Copyright 2017, Zacks Investment Research. All Rights Reserved.

CHART



DISCLOSURES

The following disclosures relate to relationships between Zacks Small-Cap Research ("Zacks SCR"), a division of Zacks Investment Research ("ZIR"), and the issuers covered by the Zacks SCR Analysts in the Small-Cap Universe.

ANALYST DISCLOSURES

I, Brian Marckx, CFA, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report. I believe the information used for the creation of this report has been obtained from sources I considered to be reliable, but I can neither guarantee nor represent the completeness or accuracy of the information herewith. Such information and the opinions expressed are subject to change without notice.

INVESTMENT BANKING AND FEES FOR SERVICES

Zacks SCR does not provide investment banking services nor has it received compensation for investment banking services from the issuers of the securities covered in this report or article.

© Copyright 2017, Zacks Investment Research. All Rights Reserved.

Zacks SCR has received compensation from the issuer directly or from an investor relations consulting firm engaged by the issuer for providing non-investment banking services to this issuer and expects to receive additional compensation for such non-investment banking services provided to this issuer. The non-investment banking services provided to the issuer includes the preparation of this report, investor relations services, investment software, financial database analysis, organization of non-deal road shows, and attendance fees for conferences sponsored or co-sponsored by Zacks SCR. The fees for these services vary on a per-client basis and are subject to the number and types of services contracted. Fees typically range between ten thousand and fifty thousand dollars per annum. Details of fees paid by this issuer are available upon request.

POLICY DISCLOSURES

This report provides an objective valuation of the issuer today and expected valuations of the issuer at various future dates based on applying standard investment valuation methodologies to the revenue and EPS forecasts made by the SCR Analyst of the issuer's business.
SCR Analysts are restricted from holding or trading securities in the issuers that they cover. ZIR and Zacks SCR do not make a market in any security followed by SCR nor do they act as dealers in these securities. Each Zacks SCR Analyst has full discretion over the valuation of the issuer included in this report based on his or her own due diligence. SCR Analysts are paid based on the number of companies they cover. SCR Analyst compensation is not, was not, nor will be, directly or indirectly, related to the specific valuations or views expressed in any report or article.

ADDITIONAL INFORMATION

Additional information is available upon request. Zacks SCR reports and articles are based on data obtained from sources that it believes to be reliable, but are not guaranteed to be accurate nor do they purport to be complete. Because of individual financial or investment objectives and/or financial circumstances, this report or article should not be construed as advice designed to meet the particular investment needs of any investor. Investing involves risk. Any opinions expressed by Zacks SCR Analysts are subject to change without notice. Reports or articles or tweets are not to be construed as an offer or solicitation of an offer to buy or sell the securities herein mentioned.