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Icad Inc

(ICAD-NASDAQ)

ICAD: Axxent Revenue Jumps To Record Quarter. Fundamentals Ripe For Revenue and Earnings Growth.

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	07/29/2011
Current Price (11/01/12)	$2.17
Target Price	**$5.75**

OUTLOOK

The hangover from the Flexishield recall is largely behind iCAD, an additional CPT code (for treatment planning for IORT) became effective for 2012 thereby increasing reimbursement and Medicare reimbursement should again increase in 2013, and IORT therapy has become much more recognizable (to the clinical as well as patient communities) as a potentially superior alternative to conventional radiation treatment (for those patients where it's appropriate). All of this, combined with certain benefits of iCAD's Axxent System compared to competitors' electronic brachytherapy systems, appears to be taking hold as iCAD has recently shown a meaningful jump in the number of Axxent Systems and related consumables sold. This coupled with a stringent focus on cost control and a new game plan to spark growth in the Cancer Detection segment could mark an important inflection point for iCAD.
We are maintaining our Outperform rating.

SUMMARY DATA

52-Week High	**$4.00**
52-Week Low	**$1.75**
One-Year Return (%)	**-41.45**
Beta	**1.43**
Average Daily Volume (sh)	**9,828**
Shares Outstanding (mil)	**11**
Market Capitalization ($mil)	**$22**
Short Interest Ratio (days)	**4.94**
Institutional Ownership (%)	**19**
Insider Ownership (%)	**13**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-2.9**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2012 Estimate	**N/A**
P/E using 2013 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**N/A,**
Type of Stock	**Small-Value**
Industry	**Comp-Software**

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	7,344 A	6,646 A	8,052 A	6,610 A	28,652 A
2012	6,343 A	5,931 A	8,183 A	8,022 E	28,479 E
2013					40,497 E
2014					56,564 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	-$0.39 A	-$0.47 A	-$2.28 A	-$0.20 A	-$3.35 A
2012	-$0.21 A	-$0.27 A	-$0.14 A	-$0.17 E	-$0.78 E
2013					-$0.58 E
2014					-$0.17 E

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

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WHAT'S NEW…

Q3 RESULTS

iCAD (ICAD) announced financial results for the third quarter ending September 30, 2012 on October 31st. Results were anything but frightening with revenue coming in almost dead-on with our number (although with a different mix, CAD vs. Brachy) and net income / EPS beating handily. While the CAD business continues to contract due mostly to the ever dwindling number of mammography facilities that have yet to switch from film to digital, this was more than offset by very strong revenue in the Xoft business, which represents the major growth driver of iCAD over the long-term.

Importantly it's clear that iCAD is not just focused on growing the top-line without regard to operating expenses or margins. Instead, management has done an impressive job of trimming operating expenses and gross margins have actually ticked up slightly (at an impressive 70%+) over the last several quarters all while stabilizing revenue in the face of the stiff film-to-digital headwind. Management's recent shift with the Cancer Detection segment to a greater focus on services and a conventional software business model including selling product upgrades and service warranties to their sizeable (yet largely under-tapped) existing installed customer base should help stem a long-term ongoing slide in revenue from this segment. As iCAD recently explained, their new focus is on introducing and selling product upgrades and service contracts to their installed base of approximately 3.5k and in particular, the 2.5k that are using an iCAD product but are not active customers (i.e. - those that don't have a service contract or other revenue stream). iCAD will also be offering customers the option of an annual subscription to some of their products in lieu of a perpetual license, which may be especially attractive to lower volume facilities that can't justify the cost or burden of a long-term commitment. Selling product upgrades and service warranties targeted at existing accounts is also a potentially highly efficient use of resources and headcount which should benefit margins and the bottom line.

Revenue from the Xoft business took longer than initially anticipated to gain traction following iCAD's December 2010 acquisition due to certain hindrances including the Flexishield recall in February 2011 and less favorable Medicare reimbursement in 2011. The benefits of IORT compared to conventional radiation treatment, particularly for breast cancer, had also just began to gain more visibility following the release of initial data from the pivotal TARGIT study in June 2010.

Fast-forward to today and the hangover from the Flexishield recall is largely behind iCAD (although potential legal liability remains), an additional CPT code (for treatment planning for IORT) became effective for 2012 thereby increasing reimbursement and Medicare reimbursement should again increase in 2013, and IORT therapy has become much more recognizable (to the clinical as well as patient communities) as a potentially superior alternative to conventional radiation treatment (for those patients where it's appropriate). All of this, combined with certain benefits of iCAD's Axxent System compared to competitors' electronic brachytherapy systems (which we detailed in our July 7, 2011 initiation report on iCAD), appears to be taking hold as iCAD has recently shown a meaningful jump in the number of Axxent Systems and related consumables sold.

Revenue
Revenue of $8.2MM was up 2% y-o-y and in-line with our $8.1MM estimate.

- **Cancer Detection:** $3.8MM actual vs. $5.0MM estimate

  - With the new revenue reporting structure iCAD implemented beginning in Q1 2012, they now do not break out Digital & MRI CAD revenue versus Film-based revenue as had been the case previously. Total product revenue in cancer detection was about $2.0MM, down from about $4.4MM in Q3 2011 and well below our $3.5MM estimate. Management again noted on the earnings call that their OEM partners have been losing market share which continues to impact iCAD's Detection segment - this includes share losses to the likes of Hologic, at least some of which relates to more attractive price-points with some of Hologics' offerings. While the Detection segment benefitted from new product introductions including PowerLook AMP which launched over the Summer and growth in the number of digital products under service agreements, these weren't nearly enough to offset contraction in other areas. Going forward we think new products such as PowerLook Amp, iCAD's next-generation mammography CAD system which includes highly sought after breast density functionality, CAD for tomosynthesis (3D mammography) which is currently in the planning

phase, and growth in sales of services and licensing agreements can stabilize Cancer Detection revenue and potentially return it to growth in 2013. And while breast MRI and CT colon CAD revenue have yet to gain much traction, these remain viable growth opportunities. CT colon CAD growth remains hindered by lack of reimbursement in the U.S., although the additional data from the ACRIN study that were recently published could be a catalyst to gaining Medicare reimbursement.

- **Cancer Therapy:** $4.4MM actual vs. $3.1MM estimate

  - Cancer therapy revenue was up 146% yoy and 194% sequentially. iCAD sold a record number of Axxent System controllers and balloon applicators in Q3. 12 controllers were sold during the quarter, up from 5 in Q3 2011 and 4 in Q2 2012. Year-to-date iCAD sold 22 controllers, compared to just 10 in the first nine months of 2011. Balloon applicator (consumables used for breast IORT) sales have also significantly increased. 190 balloon applicators were sold in Q3 2012, compared to 41 in Q3 2011 (+363% yoy) and 161 in Q2 2012 (+18% sequentially). As we noted above, growth appears to be the result of a number of factors including more favorable reimbursement and greater awareness of the benefits of IORT compared to traditional whole breast radiation therapy. In addition, management noted that there is substantial interest and procedural volume (skin cancer treatment typically requires more than one visit) coming for use in skin cancer, namely non-melanoma skin cancer.

    We note that utilization remains fairly low, by our estimates each installed console is only being used approximately 3x per month for IORT breast cancer therapy. This procedural volume rate per unit will almost certainly substantially increase as demand for IORT continues to grow and providers look to maximize utilization (in breast as well as skin and other cancers) and speed break even on the cost of the (~$275k) of the console. As the utilization rate grows so will iCAD's revenue growth rate. We model a very incremental step-up in utilization over the next several years which could actually end up being somewhat conservative. A larger installed base means greater recurring revenue from consumables including balloon catheters and x-ray sources as well as annual service contract revenue, all of which we estimate generate relatively high margins to iCAD compared to that of the consoles.

    Relative to Medicare reimbursement, as a reminder reimbursement amounts for 2012 unexpectedly bundled the IORT therapy with the surgery, limiting the economics for radiation oncologists to use Axxent. This is set to change for 2013 as CMS has proposed a rule (which is expected to be finalized any day) which will assign a separate payment for IORT treatment delivery. This will essentially have the effect of increasing reimbursement to the provider in the amount of $496. iCAD was very active in pursuit of getting the IORT treatment reimbursed separately from the surgical component (and clearly successfully so) and indicated that a code specific to skin cancer may be an upcoming endeavor. If established, this could create more widespread reimbursement with Axxent for skin cancer treatment, which is currently somewhat payer and region specific.

EPS

Q3 EPS of ($0.14) came in substantially better than our ($0.20) estimate as a result of wider than modeled gross margin (71.9% A vs. 68.2% E) and iCAD's continued cost-cutting efforts. Management clearly remains very diligent on cost control with operating expenses coming in well below our expectations ($6.5MM A vs. $7.4MM E). As an illustration of their efficiency efforts over the last several quarters, operating expenses through the first nine months of 2012 were $19.0 million on revenue of $20.5 million compared to operating expenses of $29.7 million on revenue of $22.0 million through the first nine months of 2011. Meanwhile gross margin has remained very healthy. GM averaged 70.4% through the first nine months of 2011 and was 70.8% through the first nine months of the current year.

Cash

iCAD exited Q3 with $13.8M in cash and equivalents, down slightly from the $14.3 million at 6/30/2012. Management noted on the call that they believe Q4 may see positive cash flow from operating activities (also implying that a drawdown in A/R may be a contributor). Given our expectations of significant revenue growth, gross margins maintained at 70%+, and incrementally increasing operating leverage, we believe that the current cash balance along with cash from operations will be more than sufficient to fund the company for the foreseeable future.

VALUATION / RECOMMENDATION

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 2012 and 2013, we calculated P/S and EV/S ratios from imaging (HOLX, MRGE) as well as surgical (VAR, ARAY, ISR) companies. The five companies currently trade at an average P/S-2012 of 1.9x and P/S-2013 of 1.4x and average EV/S-2012 of 1.9x and EV/S-2013 of 1.4x.

Based on the average of the 2012 and 2013 EV/S multiples iCAD is valued at $6.40/share. Based on the average of the 2012 and 2013 P/S multiples iCAD is valued at $5.05/share. We use the average of the two which values iCAD at approximately $5.75/share. We are maintaining our Outperform rating and recommend accumulating the stock up towards our $5.75/share price target.

FINANCIAL MODEL iCAD Inc.

	2011 A	Q1A	Q2A	Q3A	Q4E	2012 E	2013 E	2014 E	2015 E
Cancer Detection	$22,772.0	$4,339.0	$4,432.0	$3,780.0	$4,549.4	$17,100.4	$16,831.6	$18,696.9	$20,626.2
YOY Growth	*-7.3%*	*-28.0%*	*-19.1%*	*-39.7%*	*-9.1%*	*-24.9%*	*-1.6%*	*11.1%*	*10.3%*
% of total revenue	*79.5%*	*68.4%*	*74.7%*	*46.2%*	*56.7%*	*60.0%*	*41.6%*	*33.1%*	*25.3%*
Therapy	$5,881.0	$2,004.0	$1,499.0	$4,403.0	$3,472.4	$11,378.4	$23,665.3	$37,867.5	$60,846.6
YOY Growth	*-*	*51.8%*	*28.4%*	*146.3%*	*116.2%*	*93.5%*	*108.0%*	*60.0%*	*60.7%*
% of total revenue	*20.5%*	*31.6%*	*25.3%*	*53.8%*	*43.3%*	*40.0%*	*58.4%*	*66.9%*	*74.7%*
Total Revenues	$28,652.0	$6,343.0	$5,931.0	$8,183.0	$8,021.8	$28,478.8	$40,496.9	$56,564.4	$81,472.8
YOY Growth	*16.6%*	*-13.6%*	*-10.8%*	*1.6%*	*21.4%*	*-0.6%*	*42.2%*	*39.7%*	*44.0%*
Cost of Revenues	$8,624.0	$1,916.0	$1,762.0	$2,301.0	$2,335.6	$8,314.6	$12,423.1	$15,607.6	$20,066.1
Gross Income	$20,028.0	$4,427.0	$4,169.0	$5,882.0	$5,686.2	$20,164.2	$28,073.8	$40,956.8	$61,406.7
Gross Margin	*69.9%*	*69.8%*	*70.3%*	*71.9%*	*70.9%*	*70.8%*	*69.3%*	*72.4%*	*75.4%*
R&D	$10,792.0	$2,212.0	$1,975.0	$1,971.0	$2,044.0	$8,202.0	$9,242.0	$9,942.0	$12,477.0
% R&D	*37.7%*	*34.9%*	*33.3%*	*24.1%*	*25.5%*	*28.8%*	*22.8%*	*17.6%*	*15.3%*
Selling & Mktg	$13,684.0	$2,646.0	$2,488.0	$2,842.0	$2,887.8	$10,863.8	$14,457.4	$19,231.9	$27,700.8
% Sell&Mktg	*47.8%*	*41.7%*	*41.9%*	*34.7%*	*36.0%*	*38.1%*	*35.7%*	*34.0%*	*34.0%*
G&A	$10,075.0	$1,618.0	$1,618.0	$1,710.0	$1,785.0	$6,731.0	$9,395.3	$12,444.2	$17,516.7
% G&A	*35.2%*	*25.5%*	*27.3%*	*20.9%*	*22.3%*	*23.6%*	*23.2%*	*22.0%*	*21.5%*
Contingent Consideration	($4,900.0)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Goodwill Impairment	$26,828.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Operating Income	($36,451.0)	($2,049.0)	($1,912.0)	($641.0)	($1,030.6)	($5,632.6)	($5,020.9)	($661.3)	$3,712.3
Operating Margin	*-127.2%*	*-32.3%*	*-32.2%*	*-7.8%*	*-12.8%*	*-19.8%*	*-12.4%*	*-1.2%*	*4.6%*
Other income	($741.0)	$599.0	($213.0)	$126.0	$0.0	$512.0	$0.0	$0.0	$0.0
Interest income, net	($395.0)	($814.0)	($818.0)	($950.0)	($885.0)	($3,467.0)	($1,976.2)	($1,428.1)	($1,461.6)
Pre-Tax Income	($37,587.0)	($2,264.0)	($2,943.0)	($1,465.0)	($1,915.6)	($8,587.6)	($6,997.0)	($2,089.4)	$2,250.7
Taxes	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Tax Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Net Income	($36,504.0)	($2,264.0)	($2,943.0)	($1,465.0)	($1,915.6)	($8,587.6)	($6,997.0)	($2,089.4)	$2,250.7
YOY Growth	*-486.5%*	*46.1%*	*42.2%*	*94.1%*	*14.0%*	*76.5%*	*18.5%*	*70.1%*	*207.7%*
Net Margin	*-127.4%*	*-35.7%*	*-49.6%*	*-17.9%*	*-23.9%*	*-30.2%*	*-17.3%*	*-3.7%*	*2.8%*
EPS	($3.35)	($0.21)	($0.27)	($0.14)	($0.17)	($0.78)	($0.58)	($0.17)	$0.18
YOY Growth	*-2363.8%*	*45.6%*	*41.6%*	*94.1%*	*18.3%*	*76.6%*	*25.5%*	*71.1%*	*204.4%*
Pro-forma adjustments	$21,850.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pro-forma EPS	($1.34)	($0.21)	($0.27)	($0.14)	($0.17)	($0.78)	($0.58)	($0.17)	$0.18
Diluted Shares O/S	10,909	10,776	10,794	10,805	11,500	10,969	12,000	12,400	12,800

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HISTORICAL ZACKS RECOMMENDATIONS



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