Zacks Small-Cap Research

November 13, 2017

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iCAD Inc (ICAD-NASDAQ)

ICAD: Q3 Revenue Dead-On With Our Estimate. Solid Results From Both Detection and Therapy

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

Current Price (11/13/17)	$3.39
Valuation	**$7.50**

OUTLOOK

We noted in our Q2 update in August that we would be very surprised if Q2 revenue, of $6.4M, did not represent a valley and regular sequential growth did not return in Q3. We were happy to see that Q3 results were largely in-line with our expectations. This includes revenue which came in dead-on with our number and, excluding a non-cash charge to goodwill, EPS was one penny better than what we modeled. Overall, we characterize Q3 as a solid quarter from both a financial and operational perspective. On the financial side, ICAD saw solid revenue growth from both the detection and therapy segments, maintained relatively tight reins on expenses and turned in the lowest operating loss (ex-charges) in the last 5 quarters. On the operational front, indications are that roll out of tomo in both the U.S. and Europe continues to gain momentum, facilitated by marketing efforts of GE and ICAD. While certain headwinds persist, we expect these to diminish over time. Hospital budget-resets, along with overall industrywide growth in adoption of 3D technology are expected to steepen the rate of system placements and upgrades. On the therapy side, eBx skin utilization continued to climb in Q3 as did IORT procedural volumes.

SUMMARY DATA

52-Week High	**$6.07**
52-Week Low	**$3.10**
One-Year Return (%)	**-3.08**
Beta	**1.59**
Average Daily Volume (sh)	**43,983**
Shares Outstanding (mil)	**16**
Market Capitalization ($mil)	**$56**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**23**
Insider Ownership (%)	**19**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-3.2**
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	**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)
2016	6038 A	7369 A	6003 A	6928 A	26338 A
2017	6791 A	6409 A	7000 A	7390 E	27590 E
2018					38439 E
2019					48693 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	-$0.14 A	-$0.14 E	-$0.62 E
2018					-$0.35 E
2019					$0.05 E

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

Q3 2017 Results: Revenue Dead-On With Our Estimate. Solid Results From Both Detection and Therapy…

iCAD reported Q3 financial results for their third quarter ending September 30th. As a reminder, we noted in our Q2 update in August that we would be very surprised if Q2 revenue, of $6.4M, did not represent a valley and regular sequential growth did not return in Q3.

We were happy to see that Q3 results were largely in-line with our expectations. This includes revenue which came in dead-on with our number and, excluding a non-cash charge to goodwill, EPS was one penny better than what we modeled. Overall, we characterize Q3 as a solid quarter – from both a financial and operational perspective.

On the financial side, ICAD saw solid revenue growth from both the detection and therapy segments, maintained relatively tight reins on expenses and turned in the lowest operating loss (ex-charges) in the last five quarters.

And on the operational front, indications are that roll out of tomo in both the U.S. and Europe continues to gain momentum, facilitated by marketing efforts of GE and ICAD. While certain headwinds persist, we expect these to diminish over time. Hospital budget-resets, along with overall industrywide growth in adoption of 3D technology are expected to steepen the rate of system placements and upgrades. Importantly, early customer feedback appears to be highly positive. On the therapy side, eBx skin utilization continued to climb in Q3 as did IORT procedural volumes.

Total Revenue: $7.0M (vs. $7.0M estimate) up 17% yoy, up 9% sequentially

While on a GAAP basis revenue was up 17% yoy, on an apples-to-apples basis, results were even stronger. As a reminder, the company's MRI assets were sold in Q1 of this year. Stripping out MRI revenue, which contributed almost $600k in the prior-year period, means revenue from comparable operations grew 29% from Q3 2016.

Ex-MRI, the total yoy revenue growth of $1.6M was fairly evenly split (on a $ basis) between Detection (~$813k) and Therapy (~$758k). All of the Detection segments' 23% growth came from product sales while service/supplies revenue contracted by about $200k. Meanwhile, both products and services/supplies contributed to the Therapy segment's yoy revenue growth. Console placements, including one for IORT breast and one GYN, contributed to 19% growth on the product side while growth in IORT and skin eBx utilization helped drive an 8% increase in service/supplies revenue.

Through the first nine months of the year, total revenue on a GAAP and ex-MRI basis grew 4% and 13%, respectively.

Cancer Detection (Q3): $4.4M (vs. $4.6M estimate): +5% (+23% organic) yoy, +3% sequentially

While ICAD does not report specifics in terms of unit or license sales, indications are that the recent tomo launches in both the U.S. and Europe have been gaining traction. Anecdotally, the Detection revenue results also support this. As a reminder, sales in Q1 of this year 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 had 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 in that quarter.

We anticipated that trend would continue through Q3 and, encouragingly, that is exactly what happened. Detection product sales were $2.76M, almost dead-on with our $2.78M forecast and up $1M, or 60% from Q3 2016 (ex-MRI). This may reflect the early fruits of marketing efforts which included a 20+ city road show by GE. ICAD has also been very actively promoting at industry events and conferences.

We continue to think the tomo-related revenue curve steepens in 2018 but also believe the very near-term rate of growth may be somewhat more tempered. A relatively steep training/learning curve for the GE sales team as a result of the much greater complexity in reading 3D versus 2D images as well budget-related gating factors may moderate incremental growth over the next three to six months, in our opinion. However, we have zero doubt that adoption of digital breast tomosynthesis will continue to accelerate, particularly as radiologists become increasingly comfortable and familiar with 3D images, and believe ICAD, with partner GE, is well-positioned to capture meaningful share of the market.

Management noted on the Q3 call that lack of appropriate budgeting for GE's higher-priced Pristina machine and ICAD's 3D tomo software has been a headwind. We think lack of widespread insurance coverage for tomo may also be somewhat of an impediment to hospitals committing to the technology. But, as the new budget years roll around and awareness builds around the benefits of 3D vs. 2D (such as lower recall rates), adoption should increase. Reading 3D images is more time consuming, however, which will drive demand for ICAD's software. Insurers who do not already reimburse for tomo will likely soon have little choice but to do so, which should help alleviate any ROI-related concerns at the provider level. GE and the other imaging manufacturers have been actively promoting at the customer level but we think that may spread to more DTC campaigns as well given power of patient influence. And, finally, providers will leverage tomo as competitive differentiation, prompting other hospitals to follow suit and also adopt the technology. As such, we expect current headwinds to adoption of 3D tomo to dissipate over time.

With approximately two-thirds of the U.S. market still yet to adopt tomosynthesis, significant upside remains. GE's plan is to sequentially grow shipments of their Pristina machine each quarter and they have been actively promoting why their technology is superior to other manufacturers'. GE notes that customer surveys indicate that 83% of patients had a better experience getting a mammography with their Pristina machine as compared to competitors' and also touts lower 3D radiation dose as competitive differentiation. Indications are that GE has been increasing sequential sales. ICAD mentioned on the Q3 call that it was evident, based on the number of units of reader software that GE purchased during the quarter, that they were selling a lot more machines than they had in the first two quarters of the year.

And while we expect to see sequential growth of ICAD's GE-only tomo product, their next-generation software 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 significantly 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 timelines to complete development and launch this next-gen product have slipped on a not-irregular basis, ICAD's most recent guidance (on the Q3 call) is largely unchanged from the most recent prior forecast (on the Q2 call in August). Management is shooting to have the product launched in Europe in 1H 2018 and in the U.S. 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. Management noted that results to-date from a pilot study, which is approximately 50% complete and precedes the pivotal study, has been "extremely encouraging". ICAD hopes to initiate the pivotal study in December and file for FDA clearance in Q1 2018.

Given the industry shift from 2D to 3D and wider breadth of machines that this second-gen product has availability for (~75% of tomo systems are non-GE machines) and its enhanced features, introduction of this could result in another, and potentially much steeper, new wave of Detection segment growth.

Cancer Therapy (Q3): $2.7M (vs. $2.4M estimate): +42% yoy, +22% sequentially

The beat to our estimate relates almost entirely to higher than anticipated therapy product sales ($668k A vs. $422 E), with services and supplies revenue coming in just about right-on-the-nose with our number ($1.99M A vs. $2.02M E).

On the hardware side, ICAD noted that they placed one system for IORT breast and one related to gynecological cancer treatment. As we have mentioned in the past, the number of capital-sale systems sold in a given quarter can be somewhat variable so the beat to our number on this line item is not necessarily fundamentally meaningful. We think capital system sales may be able to do slightly better than treading water going forward, particularly as the Xoft system expands into additional geographies. This should soon include China where ICAD's IORT balloon applicators recently received CFDA approval. This follows prior approval of the console in that country.

So while we expect hardware to remain a meaningful revenue contributor, we think services and supplies is where most of the potential for near-term growth lies within the Therapy segment. We expect the recent growth in aggregate NMSC utilization as well as an increase in the subscription customer base (and number of 'active' sites) to begin to result in a much more obvious delta to Therapy services and supplies revenue.

As noted over the last few earnings periods, there has been a positive trend in the overall number of sites as well as the number of sites treating. In Q3 ICAD added 4 new customers who are treating – 2 capital customers and 2 subscription. The total number of (net) treating sites has increased from 37 at 2016 year-end to 52 at the end of Q3. The majority of this growth has been on the subscription side, which had 27 sites treating at the end of Q3, up from just 6 at the end of 2016. Utilization has also been ramping - increasing from 7k fractions in Q4 '16 to 12k in Q2 '17 and to 15k in Q3 '17.

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 lack of significant capital console sales 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. Most recently, ICAD was busy at ASTRO 2017, presenting data from their NMSC matched-pairs study (n=369) which showed similar cancer recurrence rates at more than 3 years follow-up between eBx and Mohs surgery (i.e. standard therapy). Additionally, cosmetic outcomes were as good or better among the eBx cohort as compared to Mohs. Another ASTRO presentation, relating to the treatment of peri-ocular NMSC, showed treatment with Xoft was associated with a 99% control rate at 2 years follow-up among patients (n=86) with basal cell carcinoma and squamous cell carcinoma of the eyelid.

ICAD will continue to 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.

Relative to IORT, management noted that IORT balloon sales increased about 10% through the first 9 months of 2017, with much of that growth coming from international markets. OUS growth has been a focus and catalyzed by expansion into additional countries. That could be further stoked with entry into China. As noted, regulatory approval of Xoft and the IORT balloon applicators was just obtained in China. The relatively enormous population, combined with the convenience of radiation therapy at the time of surgery with eBx (versus traditional radiation which requires multiple trips back following lumpectomy), are reasons why ICAD believes China could represent another significant market for Xoft.

ICAD also recently launched an applicator for cervical cancer (GYN) which represents another potential area of growth - early indications suggest growing international demand in this application

Relative to the U.S., ICAD noted that balloon sales in Q3 were particularly strong, although it is unclear whether this is indicative of fundamental strength or something else, such as favorable timing. But management did mention that they expect growth in systems placements in both the U.S. and internationally in Q4 of this year.

We think the U.S. holds opportunity for future growth, particularly with additional clinical data supporting the benefits of IORT over traditional radiation regimens. 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.

Model / Valuation

Model Updates
We have made only incremental updates to our financial model following Q3 results.

We have both Therapy and Detection revenue growing sequentially from Q3 to Q4. On the Therapy side, have revenue growing 3% from Q3 (implying 7% growth for the full year) 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. For 2018 we have Therapy revenue growing 16%, most of which is utilization driven.

Meanwhile, we have Detection revenue growing 12% from Q3 to Q4 (implying 4% growth for the full year, which is not adjusted for the MRI CAD revenue). For 2018 we have Detection growing a relatively robust 53%, most of which reflects expectations of erosion of various early headwinds to steepening adoption of 3D tomo that we outlined in our report. We continue to model additional contribution from 3D tomo into 2019, facilitated by launch of the next-gen product.

ICAD was quick to cut costs following revelation of the NMSC reimbursement change. Additional cost-control measures have helped to further improve financial results including operating loss, which at $2.2M (ex-charge to goodwill), was the lowest since Q2 2016. 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) and $4.7M charge to Therapy-related goodwill (Q3), we model 2017 EPS of ($0.62), revised from ($0.64).

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-2018 of 3.1x and P/S-2019 of 2.7x and average EV/S-2018 of 3.0x and EV/S-2019 of 2.6x.

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

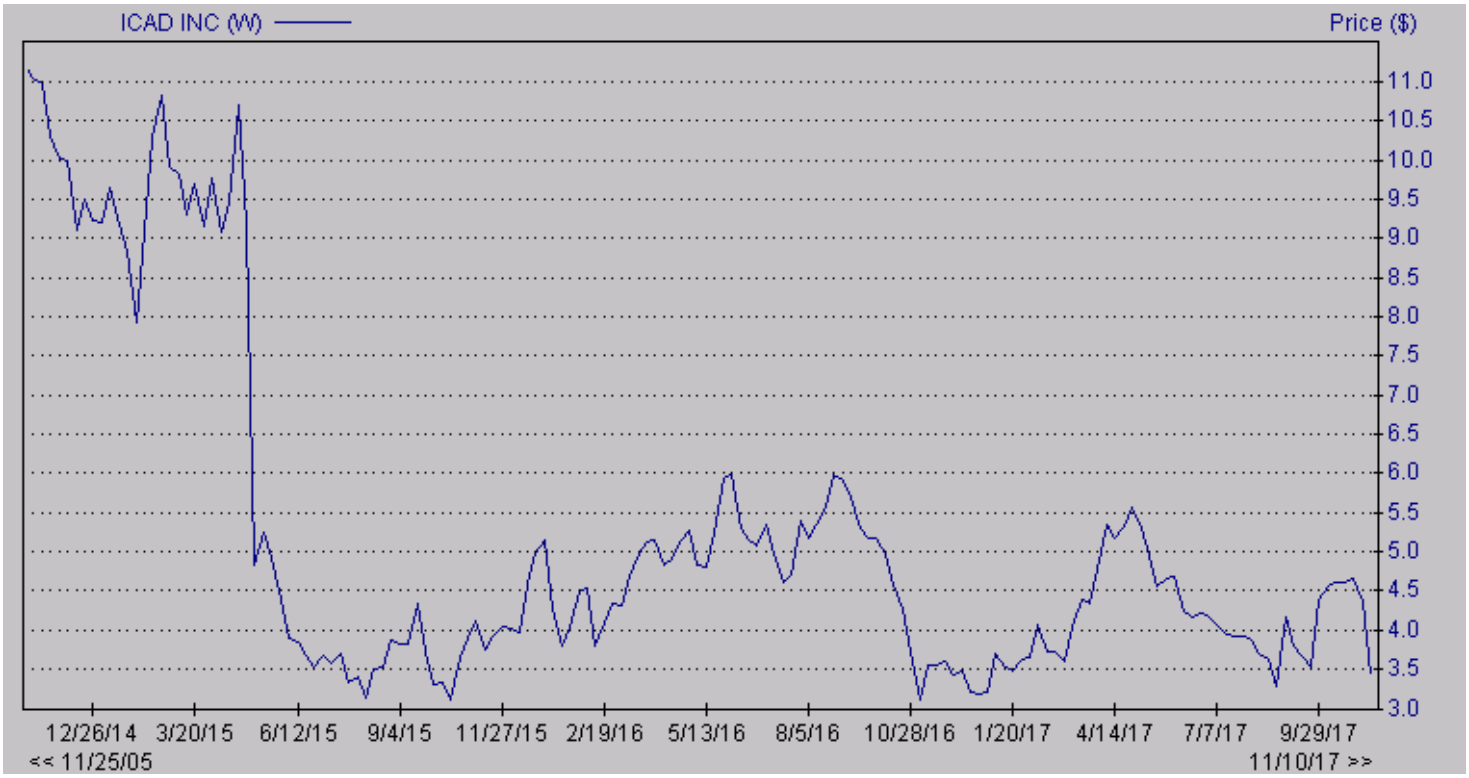
FINANCIAL MODEL

iCAD Inc.

	2016 A	Q1A	Q2A	Q3A	Q4E	2017 E	2018 E	2019 E
Cancer Detection	$17,133.0	$4,489.0	$4,231.0	$4,346.0	$4,664.5	$17,730.5	$27,051.1	$34,688.0
YOY Growth	*-11.0%*	*14.2%*	*-13.6%*	*5.1%*	*11.8%*	*3.5%*	*52.6%*	*28.2%*
% of total revenue	*65.1%*	*66.1%*	*66.0%*	*62.1%*	*63.1%*	*64.3%*	*70.4%*	*71.2%*
Therapy	$9,205.0	$2,302.0	$2,178.0	$2,654.0	$2,725.0	$9,859.0	$11,388.0	$14,005.0
YOY Growth	*-58.7%*	*9.2%*	*-11.9%*	*42.0%*	*-1.1%*	*7.1%*	*15.5%*	*23.0%*
% of total revenue	*34.9%*	*33.9%*	*34.0%*	*37.9%*	*36.9%*	*35.7%*	*29.6%*	*28.8%*
Total Revenues	$26,338.0	$6,791.0	$6,409.0	$7,000.0	$7,389.5	$27,589.5	$38,439.1	$48,693.0
YOY Growth	*-36.6%*	*12.5%*	*-13.0%*	*16.6%*	*6.7%*	*4.8%*	*39.3%*	*26.7%*
Cost of Revenues	$7,820.0	$2,102.0	$1,906.0	$2,357.0	$2,231.0	$8,596.0	$10,765.5	$13,323.8
Gross Income	$18,518.0	$4,689.0	$4,503.0	$4,643.0	$5,158.5	$18,993.5	$27,673.6	$35,369.2
Gross Margin	*70.3%*	*69.0%*	*70.3%*	*66.3%*	*69.8%*	*68.8%*	*72.0%*	*72.6%*
R&D	$9,518.0	$2,574.0	$2,232.0	$2,254.0	$2,344.0	$9,404.0	$9,784.0	$10,101.0
% R&D	*36.1%*	*37.9%*	*34.8%*	*32.2%*	*31.7%*	*34.1%*	*25.5%*	*20.7%*
Selling & Mktg	$10,179.0	$2,902.0	$2,690.0	$2,580.0	$2,771.1	$10,943.1	$12,838.7	$14,072.3
% Sell&Mktg	*38.6%*	*42.7%*	*42.0%*	*36.9%*	*37.5%*	*39.7%*	*33.4%*	*28.9%*
G&A	$8,791.0	$2,156.0	$2,205.0	$2,051.0	$2,351.0	$8,763.0	$10,864.0	$11,744.0
% G&A	*33.4%*	*31.7%*	*34.4%*	*29.3%*	*31.8%*	*31.8%*	*28.3%*	*24.1%*
Goodwill Impairment	$0.0	$0.0	$0.0	$4,700.0	$0.0	$4,700.0	$0.0	$0.0
Operating Income	($9,970.0)	($2,943.0)	($2,624.0)	($6,942.0)	($2,307.6)	($14,816.6)	($5,813.1)	($548.1)
Operating Margin	*-37.9%*	*-43.3%*	*-40.9%*	*-99.2%*	*-31.2%*	*-53.7%*	*-15.1%*	*-1.1%*
Other income	$9.0	$2,508.0	$0.0	$3.0	$0.0	$2,511.0	$0.0	$0.0
Other income, net	($53.0)	$2,503.0	($10.0)	($33.0)	($75.5)	$2,384.5	($315.5)	($367.0)
Pre-Tax Income	($10,023.0)	($440.0)	($2,634.0)	($6,975.0)	($2,383.1)	($12,432.1)	($6,128.6)	($915.1)
Taxes	$76.0	$17.0	($3.0)	($42.0)	($19.1)	($47.1)	$0.0	$0.0
Tax Rate	*-0.8%*	*-3.9%*	*0.1%*	*0.6%*	*0.8%*	*0.4%*	*0.0%*	*0.0%*
Net Income	($10,099.0)	($457.0)	($2,631.0)	($6,933.0)	($2,364.0)	($12,385.0)	($6,128.6)	($915.1)
YOY Growth	*69.0%*	*82.0%*	*-67.0%*	*-159.2%*	*28.7%*	*-22.6%*	*50.5%*	*85.1%*
Net Margin	*-38.3%*	*-6.7%*	*-41.1%*	*-99.0%*	*-32.0%*	*-44.9%*	*-15.9%*	*-1.9%*
EPS	($0.63)	($0.03)	($0.16)	($0.42)	($0.14)	($0.75)	($0.35)	($0.05)
YOY Growth	*69.5%*	*82.3%*	*-62.9%*	*-151.8%*	*31.2%*	*-19.3%*	*53.6%*	*85.3%*
Pro-forma adjustments	$0.0	($2,508.0)	$0.0	$4,700.0	$0.0	$4,700.0	$0.0	$0.0
Pro-forma EPS	($0.63)	($0.18)	($0.16)	($0.14)	($0.14)	($0.62)	($0.35)	($0.05)
Diluted Shares O/S	15,975	16,135	16,310	16,424	16,800	16,417	17,500	17,800

Brian Marckx, CFA

HISTORICAL STOCK CHART



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