ICAD INC
Form 10-Q
November 10, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2011

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 1-9341

iCAD, Inc.

(Exact name of registrant as specified in its charter)

Delaware	02-0377419
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
98 Spit Brook Road, Suite 100, Nashua, NH	03062
(Address of principal executive offices)	(Zip Code)

(603) 882-5200

(Registrant s telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days. YES þ NO o.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES þ NO o.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated filer o	Accelerated filer o	Non-accelerated filer o (do not check if a smaller reporting company)	Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) YES o NO þ.

As of the close of business on November 7, 2011 there were 54,683,300 shares outstanding of the registrant s Common Stock, $.01 par value.

iCAD, Inc.
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iCAD, INC. AND SUBSIDIARY
Consolidated Balance Sheets
(Unaudited)
(In thousands except for share data)

	September 30, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 5,288	$ 16,269
Trade accounts receivable, net of allowance for doubtful accounts of $50 in 2011 and 2010	5,656	3,389
Inventory, net	2,132	3,489
Prepaid expenses and other current assets	576	581
Total current assets	13,652	23,728
Property and equipment, net of accumulated depreciation and amortization of $2,600 in 2011 and $2,852 in 2010	2,118	2,774
Other assets	604	675
Intangible assets, net of accumulated amortization of $8,317 in 2011 and $6,746 in 2010	17,584	21,165
Goodwill	20,907	45,689
Total assets	$ 54,865	$ 94,031
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 2,407	$ 2,500
Accrued and other expenses	4,518	5,902
Deferred revenue	5,702	4,906
Total current liabilities	12,627	13,308
Contingent consideration		5,000
Deferred revenue, long-term portion	1,628	961
Other long-term liabilities	1,000	1,552
Total liabilities	15,255	20,821
Commitments and Contingencies (see Note 5)		
Stockholders equity:		
Preferred stock, $.01 par value: authorized 1,000,000 shares; none issued		

Common stock, $.01 par value: authorized 85,000,000 shares; issued 54,751,176 in 2011 and 54,383,747 in 2010; outstanding 54,683,300 in 2011 and 54,315,871 in 2010		547		544
Additional paid-in capital		163,775		163,101
Accumulated deficit		(123,762)		(89,485)
Treasury stock at cost (67,876 shares)		(950)		(950)
Total stockholders equity		39,610		73,210
Total liabilities and stockholders equity	$	54,865	$	94,031

See accompanying notes to consolidated financial statements.

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iCAD, INC. AND SUBSIDIARY
Consolidated Statements of Operations
(Unaudited)
(In thousands except for per share data)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenue:				
Products	$ 5,754	$ 4,059	$ 15,463	$ 13,987
Service and supplies	2,298	1,527	6,579	4,217
Total revenue	8,052	5,586	22,042	18,204
Cost of revenue:				
Products	1,280	544	3,627	1,769
Service and supplies	650	587	2,191	1,792
Amortization of acquired intangibles	233		700	
Total cost of revenue	2,163	1,131	6,518	3,561
Gross profit	5,889	4,455	15,524	14,643
Operating expenses:				
Engineering and product development	2,630	1,715	8,709	4,796
Marketing and sales	3,108	2,347	10,780	7,363
General and administrative	2,147	1,805	8,363	6,131
Contingent consideration	(3,800)		(4,900)	
Goodwill impairment	26,750		26,750	
Total operating expenses	30,835	5,867	49,702	18,290
Loss from operations	(24,946)	(1,412)	(34,178)	(3,647)
Gain on sale of patent				275
Interest (expense) income net	(37)	19	(99)	58
Net loss	$ (24,983)	$ (1,393)	$ (34,277)	$ (3,314)
Net loss per share:				
Basic and diluted	$ (0.46)	$ (0.03)	$ (0.63)	$ (0.07)

Weighted average number of shares used in computing loss per share:				
Basic and diluted	54,681	45,922	54,533	45,782

See accompanying notes to consolidated financial statements.

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iCAD, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows
(In thousands)
(unaudited)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash flows from operating activities:		
Net loss	$ (34,277)	$ (3,314)
Adjustments to reconcile net loss to net cash (used for) provided by operating activities:		
Depreciation	813	367
Amortization	1,570	875
Loss on disposal of assets	21	
Goodwill impairment	26,750	
Stock based compensation	684	1,261
Gain on sale of patent		(275)
Interest on royalty obligation	122	
Fair value of contingent consideration	(4,900)	
Changes in operating assets and liabilities:		
Accounts receivable	(2,267)	1,574
Inventory	1,357	393
Prepaid expenses, other current assets and deposits	75	(79)
Accounts payable	(93)	(255)
Accrued salaries, warranty and other expenses	(703)	499
Deferred revenue	1,384	877
Net cash (used for) provided by operating activities	(9,464)	1,923
Cash flows from investing activities:		
Additions to patents, technology and other	(9)	(28)
Additions to property and equipment	(233)	(232)
Proceeds from sale of patent		275
Cash paid for acquisition of Xoft	(1,268)	
Net cash (used for) provided by investing activities	(1,510)	15
Cash flows from financing activities:		
Taxes paid related to restricted stock issuance	(7)	(70)
Net cash used for financing activities	(7)	(70)

Increase (decrease) in cash and equivalents		(10,981)		1,868
Cash and equivalents, beginning of period		16,269		16,248
Cash and equivalents, end of period	$	5,288	$	18,116

See accompanying notes to consolidated financial statements.

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iCAD, INC. AND SUBSIDIARY.
Notes to Consolidated Financial Statements
(Unaudited)
September 30, 2011

Note 1 Basis of Presentation and Significant Accounting Policies

The accompanying consolidated financial statements of iCAD, Inc. and subsidiary (iCAD or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP). In the opinion of management, these unaudited interim consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the financial position at September 30, 2011, the results of operations for the three and nine month periods ended September 30, 2011 and 2010, and cash flows for the nine month periods ended September 30, 2011 and 2010. Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information normally included in the footnotes prepared in accordance with US GAAP has been omitted as permitted by the rules and regulations of the Securities and Exchange Commission (SEC). The accompanying financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2010 filed with the SEC on March 30, 2011. The results for the three and nine month periods ended September 30, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2011, or any future period. Interim period amounts are not necessarily indicative of the results of operations for the full fiscal year.

Subsequent Events

We evaluated all subsequent events that occurred after the balance sheet date through the date and time our financial statements were issued.

Revenue Recognition

The Company recognizes revenue when the product ships provided title and risk of loss has passed to the customer, persuasive evidence of an arrangement exists, fees are fixed or determinable, collectability is probable and there are no uncertainties regarding customer acceptance.

The Company recognizes revenue from the sale of certain of its MRI CAD products and services in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 985-605, (Software, Revenue Recognition) (ASC 985-605).

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iCAD, INC. AND SUBSIDIARY.
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The Company recognizes revenue from the sale of the digital, film-based CAD and electronic brachytherapy products and services in accordance with ASU No. 2009-13, Multiple-Deliverable Revenue Arrangements (ASU 2009-13). In accordance with the guidance of ASU 2009-13, fair value as the measurement criteria is replaced with the term selling price and establishes a hierarchy for determining the selling price of a deliverable. ASU 2009-13 also eliminates the use of the residual value method for determining the allocation of arrangement consideration. For multi-element arrangements, revenue is allocated to all deliverables based on their relative selling prices. In such circumstances, a hierarchy is used to determine the selling price to be used for allocating revenue to deliverables as follows: (i) vendor-specific objective evidence of fair value (VSOE), (ii) third-party evidence of selling price (TPE), and (iii) best estimate of the selling price (BESP). VSOE generally exists only when the deliverable is sold separately and is the price actually charged for that deliverable. The process for determining an BESP for deliverables without VSOE or TPE considers multiple factors including relative selling prices; however, these may vary depending upon the unique facts and circumstances related to each deliverable.

Sales of the electronic brachytherapy product typically include several devices, accessories, service and supply. The Company generally allocates revenue to the deliverables in the arrangement based on the BESP. Revenue is recognized when the product has been delivered, and service and supply revenue is recognized over the life of the service and supply agreement.

For most of iCAD s Digital, MRI and film based sales, the responsibility for the installation process lies with its Original Equipment Manufacturer (OEM) partners, GE Healthcare, Siemens Medical and others. On occasion, when iCAD is responsible for product installation, the installation element is considered a separate unit of accounting because the delivered product has stand alone value to the customer. In these instances, the Company allocates the deliverables based on the framework established within ASU 2009-13. Therefore, the installation and training revenue is recognized as the services are performed. The adoption of ASU 2009-13 did not have a material effect on the financial condition or results of operations of the Company.

The Company uses customer purchase orders that include all terms of the arrangement and in the case of OEM customers are also supported by distribution agreements. The Company generally ships Free On Board shipping point and uses shipping documents and third-party proof of delivery to verify delivery and transfer of title. In addition, the Company assesses whether collection is reasonably assured by considering a number of factors, including past transaction history with the customer and the creditworthiness of the customer, as obtained from third party credit references.

If the terms of the sale include customer acceptance provisions and compliance with those provisions cannot be demonstrated, all revenues are deferred and not recognized until such acceptance occurs. The Company considers all relevant facts and circumstances in determining when to recognize revenue, including contractual obligations to the customer, the customer s post-delivery acceptance provisions, if any, and the installation process.

The Company defers revenue from the sale of extended service contracts related to future periods and recognizes revenue on a straight-line basis in accordance with FASB ASC Topic 605-20, Services . The Company provides for estimated warranty costs on original product warranties at the time of sale.

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The Company also adopted ASC Update No. 2009-14, Certain Arrangements That Contain Software Elements (Update No. 2009-14). This Update amended the scope of ASC Subtopic No. 985-605, Revenue Recognition , to exclude tangible products that include software and non-software components that function together to deliver the product s essential functionality. The adoption of this standard did not have a material effect on its financial condition or results of operations.

Cost of Revenue

Cost of revenue consists of the costs of products purchased for resale, cost relating to service including costs of service contracts to maintain equipment after the warranty period, product installation, training, customer support, certain warranty repair costs, inbound freight and duty, manufacturing, warehousing, material movement, inspection, scrap, rework, depreciation and in-house product warranty repairs. The Company has reclassified on the statement of operations for the three and nine months ended September 30, 2010, the cost of product installation, training, customer support and certain warranty repair costs of approximately $420,000 and $1.3 million, respectively that were previously included in sales and marketing expenses to cost of revenue to conform to current period classifications.

Note 2 Net Loss per Common Share

The Company s basic net loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding for the period and, if there are dilutive securities, diluted loss per share is computed by including common stock equivalents which includes shares issuable upon the exercise of stock options, net of shares assumed to have been purchased with the proceeds, using the treasury stock method.

A summary of the Company s calculation of loss per share is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Net loss	**$ (24,983)**	**$ (1,393)**	**$ (34,277)**	**$ (3,314)**
Basic shares used in the calculation of net loss per share	54,681	45,922	54,533	45,782
Effect of dilutive securities:				
Stock options				
Restricted stock				
Diluted shares used in the calculation of net loss per share	54,681	45,922	54,533	45,782
Net loss per share basic	$ (0.46)	$ (0.03)	$ (0.63)	$ (0.07)
Net loss per share diluted	$ (0.46)	$ (0.03)	$ (0.63)	$ (0.07)

As of September 30, 2011 and 2010, there were 5.7 million and 6.0 million shares of the Company s common stock, respectively issuable upon the exercise of stock options and warrants and vesting of restricted stock that were excluded from the calculation of diluted net loss per share because their effect would have been antidilutive.

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Note 3 Acquisition of Xoft

On December 30, 2010, the Company completed its acquisition of Xoft, Inc. (Xoft), a privately held company based in California. Xoft designs, develops, manufactures, markets and sells electronic brachytherapy (eBx) products for the treatment of breast and other cancers, used in a broad range of clinical settings. The acquisition was made pursuant to an Agreement and Plan of Merger dated December 15, 2010, by and between the Company, XAC, Inc., a wholly-owned subsidiary of the Company (the Merger Sub), Xoft and Jeffrey Bird as the representative of the stockholders of Xoft (the Merger Agreement). Upon the terms of the Merger Agreement, Xoft was merged with and into the Merger Sub with the Merger Sub surviving the merger (the Merger).

The Company acquired 100% of the outstanding stock of Xoft in exchange for 8,348,501 shares of the Company s common stock and approximately $1.2 million in cash, of which approximately $972,000 was accrued at December 31, 2010 and paid in January 2011, for a total consideration at closing of approximately $12.9 million based on a per share value of $1.40, the closing price of the Company s common stock on the closing date. The Company also paid certain transaction expenses of Xoft totaling approximately $1.0 million which were accrued as of December 31, 2010 and paid in January 2011. Following completion of the Merger, Xoft stockholders owned approximately 15.4% of the Company s outstanding common stock.

Under the Merger Agreement, there is an additional earn-out potential for the sellers that is tied to cumulative net revenue of Xoft products over the three years following the date of the Merger, and payable at the end of that period. The threshold for earn-out consideration begins at $50 million of cumulative revenue of Xoft Products (as defined in the Merger Agreement) from January 1, 2011 through December 31, 2013. The targeted earn-out cash consideration of $20.0 million will occur at $76.0 million of cumulative revenue of Xoft Products and the maximum earn-out consideration of $40.0 million would be achieved at $104.0 million of cumulative revenue of Xoft Products over the three year period.

At closing, 10% of the cash amount and 10% of the amount of the Company s common stock comprising the merger consideration was placed in escrow. It will remain in escrow for a period of 15 months following the closing of the Merger to secure post-closing indemnification obligations of Xoft stockholders.

The purchase price of $17.8 million, which includes $12.9 million of merger consideration and $4.9 million of contingent consideration, has been allocated to net assets acquired based upon the estimated fair value of those assets. As discussed in Note 6, at September 30, 2011 the Company has determined that the fair value of the contingent consideration is $0.0. The change in fair value of approximately $3.8 million and $4.9 million has been included in the statement of operations for the three and nine months ended September 30, 2011, respectively.

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The following is a summary of the preliminary allocation of the total purchase price based on the estimated fair values of the assets acquired and liabilities assumed as of the date of the acquisition and the amortizable lives of the intangible assets:

	Amount (000 s)	Estimated Amortizable Life
Current assets	$ 4,030	
Property and equipment	1,951	3 7 Years
Identifiable intangible assets	13,700	15 Years
Patent license	100	6 Years
Other assets	643	
Goodwill	4,142	
Current liabilities	(5,196)	
Long-term liabilities	(1,591)	
Purchase price	$ 17,779	

The goodwill of $4.1 million is not deductible for income tax purposes.

The unaudited proforma operating results for the Company for the three and nine months ended September 30, 2010, assuming the acquisition of Xoft occurred as of January 1, 2010 are as follows:

	Three months ended September 30, 2010	Nine months ended September 30, 2010
	(In thousands, except for per share data)	
Revenue	$ 6,943	$ 22,447
Loss from operations	(4,212)	(12,805)
Net loss	(4,217)	(12,869)
Net loss per share:		
Basic and Diluted	$ (0.08)	$ (0.24)

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(Unaudited)
September 30, 2011

Note 4 Stock-Based Compensation

The Company follows the guidance in FASB ASC Topic 718, Compensation Stock Compensation , (ASC 718). The Company issued 864,616 and 2,795,533 stock options in the three months and nine months ended September 30, 2011, respectively. The Company issued 200,000 and 310,000 shares of restricted stock in the three and nine months ended September 30, 2011, respectively. In the three and nine months ended September 30, 2010, the Company issued 57,700 and 186,018 stock options, respectively. The Company issued 530,500 shares of restricted stock in the nine months ended September 30, 2010. The Company did not issue any shares of restricted stock in the three months ended September 30, 2010.

In accordance with ASC 718, the Company recorded $100,000 and $684,000 of stock-based compensation expense for the three months and nine months ended September 30, 2011, respectively, and $280,000 and $1,261,000 of stock based compensation expense in the three and nine months ended September 30, 2010, respectively.

Options granted under the Company s stock incentive plans were valued utilizing the Black-Scholes model using the following assumptions and had the following fair values:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Average risk-free interest rate	2.21%	1.58%	2.78%	2.14%
Expected dividend yield	None	None	None	None