ICAD INC
Form 10-Q
August 14, 2014
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

OR

¨ **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 x NO ¨.

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 x NO ¨.

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 ¨	Accelerated filer ¨
Non-accelerated filer ¨ (do not check if a smaller reporting company)	Smaller reporting company x

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

As of the close of business on August 6, 2014 there were 15,444,059 shares outstanding of the registrant s Common Stock, $.01 par value.

Table of Contents

iCAD, Inc.

INDEX

Table of Contents

iCAD, INC. AND SUBSIDIARY

Condensed Consolidated Balance Sheets

(Unaudited)

(In thousands except for share data)

	June 30, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 34,851	$ 11,880
Trade accounts receivable, net of allowance for doubtful accounts of $50 in 2014 and $73 in 2013	9,631	7,623
Inventory, net	1,868	1,891
Prepaid expenses and other current assets	444	649
Total current assets	46,794	22,043
Property and equipment, net of accumulated depreciation and amortization of $4,042 in 2014 and $4,265 in 2013	1,703	1,671
Other assets	177	419
Intangible assets, net of accumulated amortization of $13,216 in 2014 and $12,468 in 2013	12,971	13,674
Goodwill	21,109	21,109
Total assets	$ 82,754	$ 58,916
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 2,031	$ 2,000
Accrued and other expenses	4,248	3,799
Interest payable	216	483
Notes and lease payable current portion	3,884	3,878
Warrant liability		3,986
Deferred revenue	8,581	8,306
Total current liabilities	18,960	22,452
Deferred revenue, long-term portion	1,253	1,726
Other long-term liabilities	705	1,356
Capital lease long-term portion	164	235
Notes payable long-term portion	8,747	11,770
Total liabilities	29,829	37,539

Commitments and Contingencies (Note 6)		
Stockholders equity:		
Preferred stock, $ .01 par value: authorized 1,000,000 shares; none issued.		
Common stock, $ .01 par value: authorized 20,000,000 shares; issued 14,409,016 in 2014 and 11,084,119 in 2013; outstanding 14,223,185 in 2014 and 10,898,288 in 2013	144	111
Additional paid-in capital	199,437	166,735
Accumulated deficit	(145,241)	(144,054)
Treasury stock at cost, 185,831 shares in 2014 and 2013	(1,415)	(1,415)
Total stockholders equity	52,925	21,377
Total liabilities and stockholders equity	$ 82,754	$ 58,916

See accompanying notes to condensed consolidated financial statements.

Table of Contents

iCAD, INC. AND SUBSIDIARY

Condensed Consolidated Statements of Operations

(Unaudited)

(In thousands except for per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenue:				
Products	$ 5,294	$ 4,278	$ 9,503	$ 9,112
Service and supplies	4,373	3,434	8,684	6,530
Total revenue	9,667	7,712	18,187	15,642
Cost of revenue:				
Products	1,460	1,193	2,659	2,355
Service and supplies	1,136	1,063	2,282	1,950
Amortization of acquired intangibles	241	234	482	467
Total cost of revenue	2,837	2,490	5,423	4,772
Gross profit	6,830	5,222	12,764	10,870
Operating expenses:				
Engineering and product development	2,170	1,756	4,197	3,622
Marketing and sales	2,903	2,337	5,522	4,775
General and administrative	1,923	1,602	3,671	3,274
Total operating expenses	6,996	5,695	13,390	11,671
Loss from operations	(166)	(473)	(626)	(801)
Loss from extinguishment of debt	(903)		(903)	
Gain (loss) from change in fair value of warrant	699	(571)	1,835	(140)
Interest expense	(614)	(834)	(1,431)	(1,660)
Other income	12	6	16	12
Other income (expense), net	(806)	(1,399)	(483)	(1,788)
Loss before income tax expense	(972)	(1,872)	(1,109)	(2,589)
Tax expense	(25)	(10)	(78)	(20)
Net loss and comprehensive loss	$ (997)	$ (1,882)	$ (1,187)	$ (2,609)
Net loss per share:				
Basic and diluted	$ (0.07)	$ (0.17)	$ (0.09)	$ (0.24)

Weighted average number of shares used in computing loss per share:				
Basic and diluted	14,074	10,836	12,759	10,828

See accompanying notes to consolidated financial statements.

Table of Contents

iCAD, INC. AND SUBSIDIARY

Condensed Consolidated Statements of Cash Flows

(unaudited)

	For the six months ended June 30,	
	2014	**2013**
	(in thousands)	
Cash flow from operating activities:		
Net loss	$ (1,187)	$ (2,609)
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation	432	365
Amortization	748	860
Bad debt (benefit) provision	(27)	35
Loss on extinguishment of debt	903	
(Gain) loss from change in fair value of warrant	(1,835)	140
Loss on disposal of assets		49
Stock-based compensation expense	606	601
Amortization of debt discount and debt costs	524	412
Interest on settlement obligations	106	152
Changes in operating assets and liabilities:		
Accounts receivable	(1,981)	(1,154)
Inventory	22	178
Prepaid and other current assets	96	37
Accounts payable	31	541
Accrued expenses	(576)	(1,513)
Deferred revenue	(198)	1,185
Total adjustments	(1,149)	1,888
Net cash used for operating activities	(2,336)	(721)
Cash flow from investing activities:		
Additions to patents, technology and other	(44)	(19)
Additions to property and equipment	(465)	(274)
Net cash used for investing activities	(509)	(293)
Cash flow from financing activities:		
Issuance of common stock for cash, net	28,214	
Stock option exercises	293	3
Warrant exercise	1,575	
Taxes paid related to restricted stock issuance	(101)	(25)
Payments of capital lease obligations	(65)	
Repayments of debt financing, net	(4,100)	

Net cash provided by (used for) financing activities		25,816		(22)
Increase (decrease) in cash and equivalents		22,971		(1,036)
Cash and equivalents, beginning of period		11,880		13,948
Cash and equivalents, end of period	$	34,851	$	12,912
Supplemental disclosure of cash flow information:				
Interest paid	$	1,061	$	1,052
Taxes paid	$	80	$	33
Non-cash items from investing and financing activities:				
Settlement of warrant liability with purchase of common stock	$	2,151	$	

See accompanying notes to consolidated financial statements.

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

Note 1 Basis of Presentation and Significant Accounting Policies

The accompanying condensed 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 June 30, 2014, the results of operations for the three and six month period ended June 30, 2014 and 2013, respectively, and cash flows for the six month period ended June 30, 2014 and 2013, respectively. 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, 2013 filed with the SEC on March 3, 2014. The results for the six month period ended June 30, 2014 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2014, or any future period.

Revenue Recognition

The Company recognizes revenue primarily from the sale of products and from the sale of services and supplies. Revenue is recognized when delivery has occurred, persuasive evidence of an arrangement exists, fees are fixed or determinable and collectability of the related receivable is probable. For product revenue, delivery has occurred upon shipment provided title and risk of loss have passed to the customer. Services and supplies revenue are considered to be delivered as the services are performed or over the estimated life of the supply agreement.

The Company recognizes revenue from the sale of its digital, film-based CAD and cancer therapy products and services in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Update No. 2009-13, *Multiple-Deliverable Revenue Arrangement*s (ASU 2009-13) and ASC Update No. 2009-14, *Certain Arrangements That Contain Software Elements* (ASU 2009-14) and ASC 985-605, *Software* (ASC 985-605). Revenue for the sale of certain CAD products is recognized in accordance with ASC 840 *Leases* (ASC 840). For multiple 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 BESP for deliverables without VSOE or TPE considers multiple factors including relative selling prices; competitive prices in the marketplace, and management judgment, however, these may vary depending upon the unique facts and circumstances related to each deliverable.

6

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

The Company uses customer purchase orders that are subject to the Company s terms and conditions or, in the case of an Original Equipment Manufacturer (OEM) are governed by distribution agreements. In accordance with the Company s distribution agreements, the OEM does not have a right of return, and title and risk of loss passes to the OEM upon shipment. 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 probable 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 revenue is 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 has determined that iCAD s digital, and film based sales generally follow the guidance of FASB ASC Topic 605 Revenue Recognition (ASC 605) as the software has been considered essential to the functionality of the product per the guidance of ASU 2009-14. Typically, the responsibility for the installation process lies with the OEM partner. 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 according to the BESP of the element. Revenue from the digital and film based equipment when there is installation, is recognized based on the relative selling price allocation of the BESP.

Revenue from the Company s MRI products is recognized in accordance with ASC 985-605. Sales of this product include third level OEM support, and the Company has established VSOE for this element based on substantive renewal rates for support as specified in the agreement. Product revenue is determined based on the residual value in the arrangement, and is recognized when delivered. Revenue for third-party support is deferred and recognized over the support period which is typically on an annual basis.

Sales of the Company s cancer therapy product typically include a controller, accessories, and service and source agreements. The Company allocates revenue to the deliverables in the arrangement based on the BESP in accordance with ASU 2009-13. Product revenue is generally recognized when the product has been delivered and service and source revenue is typically recognized over the life of the service and source agreement.

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

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

The Company has reclassified on the statement of operations for the three and six months ended June 30, 2013, revenue for disposable applicators and supplies of approximately $225,000 and $451,000 to service and supply revenue that was previously included in product revenue to conform to current period classification.

Cost of Revenue

Cost of revenue consists of the costs of products purchased for resale, costs 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, cost of supplies, 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 six months ended June 30, 2013, cost of revenue for disposable applicators and supplies and other related expenses of approximately $253,000 and $446,000, respectively to service and supply cost of revenue that was previously included in cost of product revenue to conform to current period classification. For the three and six months ended June 30, 2014 approximately $200,000 and $379,000, respectively and for the three and six months ended June 30, 2013, approximately $134,000 and $271,000, respectively related to Medical Device Excise tax is included in cost of product revenue.

Segments

The Company reports the results of two segments, Cancer Detection (Detection) and Cancer Therapy (Therapy). The Detection segment consists of our advanced image analysis and workflow products, and the Therapy segment consists of our radiation therapy (Axxent) products.

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

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.

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

A summary of the Company s calculation of net loss per share is as follows (in thousands except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net loss	**$ (997)**	**$ (1,882)**	**$ (1,187)**	**$ (2,609)**
Basic shares used in the calculation of net loss per share	14,074	10,836	12,759	10,828
Effect of dilutive securities:				
Stock options				
Restricted stock				
Diluted shares used in the calculation of net loss per share	14,074	10,836	12,759	10,828
Net loss per share basic and diluted	$ (0.07)	$ (0.17)	$ (0.09)	$ (0.24)

The shares of the Company s common stock, 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 is as follows:

	Period Ended June 30,	
	2014	2013
Stock Options	1,477,871	1,410,127
Warrants		550,000
Restricted Stock	326,318	220,250
Stock options, warrants and restricted stock	1,804,189	2,180,377

Note 3 Long Term Debt

In December, 2011, the Company entered into several agreements with entities affiliated with Deerfield Management, a healthcare investment fund (Deerfield), pursuant to which Deerfield agreed to provide $15 million in funding to the Company. The agreements consist of a Facility Agreement (the Facility Agreement), a Revenue Purchase Agreement (the Revenue Purchase Agreement) and the issuance of Warrants to purchase up to 550,000 shares of the Company s Common Stock at an exercise price of $3.50 (the Warrants). In accordance with the Facility Agreement, the Company is obligated to repay $15 million in three payments due as follows: $3.75 million due December 2014, $3.75 million due December 2015, and $7.5 million due December 2016, together with interest on the outstanding obligation at 5.75% per annum. The original agreement also specified the Company could extend the final payment of $7.5 million to $3.75 million in December 2016 and $3.75 million in December 2017. In accordance with the Revenue Purchase agreement, the Company was obligated to pay 4.25% of annual revenues up to $25 million, 2.75% of annual revenues from $25 million to $50 million during 2013 and 2014, and 2.25% of annual revenues during 2015, 2016 and 2017 (if the Facility Agreement was extended), and 1.0% of annual revenues in excess of $50 million.

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

On April 30, 2014, the Company agreed to pay Deerfield $4.1 million to terminate the Revenue Purchase Agreement, and eliminate the ability to extend the last debt payment for an additional year which would also eliminate the payment obligation for 2017 under the Revenue Purchase Agreement. In addition, Deerfield exercised their warrants, for an aggregate purchase price of $1,575,000, and the Company issued 450,000 shares of Common Stock to Deerfield, pursuant to the terms of the Warrants. The Warrants to purchase an additional 100,000 shares of Common Stock were cancelled, since these warrants were exercisable only in the event the Company extended the last debt payment for an additional year.

The following amounts are included in the consolidated balance sheet as of June 30, 2014 related to the Facility Agreement: (in thousands)

Principal Amount of Facility Agreement	$ 15,000
Unamortized discount	(2,503)
Carrying amount of Facility Agreement	12,497
Less current portion of Facility Agreement	(3,750)
Notes payable long-term portion	$ 8,747

The following amounts comprise interest included in our consolidated statement of operations for the three months and six months ended June 30, 2014 and 2013: (in thousands)

	Three months ended June 30,	
	2014	2013
Cash interest expense	$ 216	$ 543
Non-cash amortization of debt discount	313	169
Amortization of debt costs	28	45
Amortization of settlement obligations	54	77
Interest expense capital lease	3	
Total interest expense	$ 614	$ 834

	Six months ended June 30	
	2014	2013
Cash interest expense	$ 794	$ 1,096
Non-cash amortization of debt discount	448	323
Amortization of debt costs	76	89
Amortization of settlement obligations	106	152
Interest expense capital lease	7	
Total interest expense	$ 1,431	$ 1,660

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

Cash interest expense represents the amount of interest to be paid in cash under the Facility Agreement and the Revenue Purchase Agreement, which represents the interest of 5.75% on the Facility Agreement for the three and six months ended June 30, 2014, and the final cash payment on the Revenue Purchase Agreement for the three months ended March 31, 2014. There are no additional interest obligations for the Revenue Purchase Agreement that was terminated on April 30, 2014. Non-cash amortization is the amortization of the discount on the Facility Agreement. The amortization of debt costs relates to the costs incurred with the financing, which is primarily a facility fee and a finder s fee that were capitalized and are being expensed using the effective interest method. The amortization of the settlement obligation represents the interest associated with the settlement agreements for both Carl Zeiss Meditec AG and Hologic, Inc. Interest expense capital lease represents interest related to the capital lease as described in Note 4.

Note 4 Lease Commitments

Operating leases

Facilities are leased under operating leases expiring at various dates through September, 2017. Certain of these leases contain renewal options. For the three and six month periods ended June 30, 2014 and 2013, rent expense under operating leases was $168,000, $327,000, $168,000 and $335,000, respectively.

Future minimum lease payments as of June 30, 2014 under this lease are as follows: (in thousands)

Fiscal Year	Operating Leases
2014	$ 246
2015	482
2016	490
2017	255
	$ 1,473

Capital leases

The Company entered into a capital lease agreement for the purchase of certain equipment in August 2013 for approximately $409,000. Under the guidance of ASC Topic 840, *Leases* (ASC 840) the Company determined that the lease was a capital lease as it contained a bargain purchase option wherein the Company has the option to buy the equipment for $1 at the end of the lease term. Accordingly, the equipment has been capitalized and a liability has been recorded. The equipment cost of $409,000 is reflected as property and equipment in the balance sheet and will be

depreciated over its useful life.

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

Future minimum lease payments under this lease are as follows: (in thousands)

Fiscal Year	Capital Leases
2014	72
2015	145
2016	97
subtotal minimum lease obligation	314
less interest	(16)
Total, net	298
less current portion	(134)
long term portion	$ 164

Note 5 Stock-Based Compensation

The Company follows the guidance in ASC Topic 718, *Compensation Stock Compensation* , (ASC 718).

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 June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Average risk-free interest rate	0.85%	0.39%	0.82%	0.45%
Expected dividend yield	None	None	None	None
Expected life	3.5 years	3.5 years	3.5 years	3.5 years
Expected volatility	64.9% to 66.5%	57.7% to 58.4%	64.2% to 66.5%	57.7% to 68.9%
Weighted average exercise price	$6.72	$5.08	$7.83	$5.14
Weighted average fair value	$3.17	$2.12	$3.67	$2.25

As of June 30, 2014 unrecognized compensation cost related to unexercisable options and unvested restricted stock and the weighted average remaining period is as follows:

Remaining expense	$ 2,642,788
Weighted average term	1.35 years

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

The Company s aggregate intrinsic value for stock options and restricted stock outstanding is as follows:

Aggregate intrinsic value	**June 30, 2014**
Stock options	$ 3,186,940
Restricted stock	2,091,698

Note 6 Commitments and Contingencies

Foreign Tax Claim

In July 2007, a dissolved former Canadian subsidiary of the Company, CADx Medical Systems Inc. (CADx Medical), received a tax re-assessment of approximately $6,800,000 from the Canada Revenue Agency (CRA) resulting from CRA s audit of CADx Medical s Canadian federal tax return for the year ended December 31, 2002. In February 2010 the CRA reviewed the matter and reduced the tax re-assessment to approximately $703,000, excluding interest and penalties. The Company believes that it is not liable for the re-assessment against CADx Medical and no accrual has been recorded for this matter as of June 30, 2014.

Settlement Obligations

In connection with the acquisition of Xoft, the Company recorded a royalty obligation pursuant to a settlement agreement entered into between Xoft and Hologic in August 2007. Xoft received a nonexclusive, irrevocable, perpetual, worldwide license, including the right to sublicense certain Hologic patents, and a non-compete covenant as well as an agreement not to seek further damages with respect to the alleged patent violations. In return, the Company has a remaining obligation to pay a minimum annual royalty payment to Hologic, of $250,000 payable through 2016. In addition to the minimum annual royalty payments, the litigation settlement agreement with Hologic also provided for payment of royalties based upon a specified percentage of future net sales on any products that utilize the licensed rights. The estimated fair value of the patent license and non-compete covenant is $100,000 and is being amortized over the then estimated remaining useful life of approximately six years. In addition, a liability has been recorded within accrued expenses and long-term settlement cost for future payment and for future minimum royalty obligations totaling $596,000. The Company recorded interest expense of approximately $25,000 and $50,000 in the three and six months ended June 30, 2014, and $31,000 and $62,000 in the three and six months ended June 30, 2013, related to this obligation.

In December, 2011, the Company agreed to a settlement related to the litigation with Carl Zeiss Meditec AG. The Company is obligated to pay $0.5 million in June 2015 and $0.5 million in June 2017, for an aggregate remaining total of $1.0 million. As of June 30, 2014, the remaining liability recorded within accrued expenses and long-term settlement cost for future payment and for future minimum royalty obligations is $782,000. The Company recorded

interest expense of approximately $28,000 and $56,000 in the three and six months ended June 30, 2014, and $45,000 and $90,000 in the three and six months ended June 30, 2013, related to this obligation.

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

Other Commitments

The Company is obligated to pay approximately $1.2 million for firm purchase obligations to suppliers for future product deliverables.

Litigation

On February 18, 2011, in the Orange County Superior Court (Docket No. 30-2011-00451816-CU-PL-CXC), named plaintiffs Jane Doe and John Doe filed a complaint against Xoft, the Company, and Hoag Memorial Hospital Presbyterian asserting causes of action for general negligence, breach of warranty, and strict liability and seeking unlimited damages in excess of $25,000. On March 2, 2011, the Company received a Statement of Damages specifying that the damages being sought aggregated an amount of at least approximately $14.5 million. On April 6, 2011, plaintiffs Jane Doe and John Doe amended their complaint alleging only medical malpractice against Hoag Memorial Hospital Presbyterian. On April 8, 2011, another complaint was filed in the Orange County Superior Court (Docket No. 30-2011-00465448-CU-MM-CXC) on behalf of four additional Jane Doe plaintiffs and two John Doe spouses with identical allegations against the same defendants. One John Doe spouse from this group of plaintiffs was later dismissed on August 18, 2011. On April 19, 2011, a sixth Jane Doe plaintiff filed an identical complaint in the Orange County Superior Court (Docket No. 30-2011-00468687-CU-MM-CXC), and on May 4, 2011, a seventh Jane Doe plaintiff and John Doe spouse filed another complaint in the Orange County Superior Court (Docket No. 30-2011-00473120-CU-PO-CXC), again with identical allegations against the same defendants. On July 12, 2011, an eighth Jane Doe plaintiff and John Doe spouse filed a complaint in the Orange County Superior Court (Docket No. 30-2011-00491068-CU-PL-CXC), and on July 14, 2011, a ninth Jane Doe plaintiff and John Doe spouse filed another complaint in the Orange County Superior Court (Docket No. 30-2011-00491497-CU-PL-CXC), each with identical allegations as the previously filed complaints. On August 18, 2011, these two groups of Jane Doe plaintiffs and John Doe spouses amended their complaints to correct certain deficiencies. Additionally on August 18, 2011, a tenth Jane Doe plaintiff and two additional John Doe spouses filed a complaint in the Orange County Superior Court (Docket No. 30-2011-501448-CU-PL-CXC), again with identical allegations against the same defendants. On January 18, 2012, three additional Jane Doe plaintiffs and one additional John Doe spouse filed a complaint in the Orange County Superior Court (Docket No. 30-2012-00538423-CU-PL-CXC) with identical allegations against the same defendants. On April 11, 2012, the above-referenced cases were consolidated for all purposes, excluding trial. On May 2, 2012, plaintiffs filed a master consolidated complaint, with the same case number as the original filed complaint. On August 2, 2012, plaintiffs filed fictitious name amendments adding defendants, Mel Silverstein, M.D., Peter Chen, M.D., Lisa Guerrera, M.D., Ralph Mackintosh, Ph.D., Robert Dillman, M.D., and Jack Cox. On September 14, 2012, an additional Jane Doe plaintiff and John Doe spouse

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

filed a complaint in the Orange County Superior Court (Docket No. 30-2012-00598740-CU-PL-CXC) with identical allegations as plaintiffs above against the same original defendants. On October 17, 2012, plaintiff John Doe No. 11 dismissed his complaint, with prejudice, as to all defendants. On November 26, 2012, plaintiffs filed an additional fictitious name amendment adding defendant, American Ceramic Technology, Inc. On January 15, 2013, plaintiffs filed a dismissal, with prejudice, as to defendant, Mel Silverstein, M.D., only. On May 28, 2013, plaintiffs filed an additional fictitious name amendment adding defendant, American Ceramic Technology. On July 11, 2013, American Ceramic Technology filed a cross-complaint for express and implied indemnity, apportionment, contribution and declaratory relief against all defendants. On October 24, 2013, plaintiff s filed an amended master consolidated complaint. On January 17, 2014, Ralph Mackintosh, Ph.D., Robert Dillman, M.D., Jack Cox, and Hoag Memorial Hospital Presbyterian each filed a cross-complaint for equitable indemnity, contribution and declaratory relief against American Ceramic Technology. On June 6, 2014, American Ceramic Technology filed an amended cross-complaint. It is alleged that each Jane Doe plaintiff was a patient who was treated with the Axxent Electronic Brachytherapy System that incorporated the Axxent Flexishield Mini. The Company believes that all of the Jane Doe plaintiffs were part of the group of 29 patients treated using the Axxent Flexishield Mini as part of a clinical trial. The Axxent Flexishield Mini was the subject of a voluntary recall. These claims are still in the early stages. Based upon our preliminary analysis, the Company plans to vigorously defend the lawsuits however a loss is reasonably possible. Since the amount of the potential damages in the event of an adverse result is not reasonably estimable, we are unable to estimate a range of loss and no expense has been recorded with respect to the contingent liability associated with this matter.

Note 7 Fair Value Measurements

The Company follows the provisions of ASC Topic 820, *Fair Value Measurement and Disclosures* , (ASC 820). This topic defines fair value, establishes a framework for measuring fair value under US GAAP and enhances disclosures about fair value measurements. Fair value is defined under ASC 820 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under ASC 820 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are

observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value.

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

A financial instrument s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Our financial instruments include cash and cash equivalents, accounts receivable, accounts payable and certain accrued liabilities and our notes payable. The carrying amounts of our cash and cash equivalents (which are composed primarily of deposit and overnight sweep accounts), accounts receivable, accounts payable and certain accrued liabilities approximate fair value due to the short maturity of these instruments. The carrying value of our notes payable approximates fair value due to the market rate of the stated interest rate.

The Company s assets that are measured at fair value on a recurring basis relate to the Company s money market accounts. The Company s liabilities that are measured at fair value on a recurring basis relate to contingent consideration resulting from the acquisition of Xoft and the Warrants issued in connection with the Deerfield Facility Agreement.

The Company s money market funds are included in cash and cash equivalents in the accompanying balance sheets, and are considered a Level 1 investment as they are valued at quoted market prices in active markets.

The following table sets forth Company s assets and liabilities which are measured at fair value on a recurring basis by level within the fair value hierarchy.

Fair value measurements using: (000 s) as of December 31, 2013

	Level 1	Level 2	Level 3	Total
Assets				
Money market accounts	$ 7,572	$	$	$ 7,572
Total Assets	$ 7,572	$	$	$ 7,572
Liabilities				
Contingent Consideration	$	$	$	$
Warrants			3,986	3,986
Total Liabilities	$	$	$ 3,986	$ 3,986

Fair value measurements using: (000 s) as of June 30, 2014

	Level 1	Level 2	Level 3	Total
Assets				
Money market accounts	$ 31,608	$	$	$ 31,608
Total Assets	$ 31,608	$	$	$ 31,608

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

As discussed in Note 3, the Company issued 450,000 immediately exercisable warrants to Deerfield in December 2011. On April 30, 2014, Deerfield exercised the warrants, for an aggregate purchase price of $1,575,000, and the Company issued 450,000 shares of Common Stock. The Warrant obligation was fully satisfied following that exercise. The warrant liability for the warrants associated with the debt was valued using the binomial lattice-based valuation methodology because that model embodies all of the relevant assumptions that address the features underlying these instruments. The warrant was valued at $2,151,000 as of April 30, 2014 immediately prior to exercise and the Company recorded a gain of $699,000. Significant assumptions in valuing the warrant liability were as follows as of December 31, 2013 and April 30, 2014.

Warrants	April 30, 2014	December 31, 2013
Exercise price	$ 3.50	$ 3.50
Volatility	40.8%	56.2%
Equivalent term (years)		4.00
Risk-free interest rate	0.1%	1.3%

The volatility was determined based on the definition in the Warrants, and the risk-free interest rate was determined using the six year LIBOR as of the measurement date.

In addition the other significant assumptions include the probability of voluntary exercise versus a major transaction (as defined in the Warrants); and assuming a major transaction, the probability of cashless major exercise; and assuming a cashless major exercise, the annual probabilities for a major transaction.

The following sets forth a reconciliation of the changes in the fair value of warrants payable during the period:

Warrants	**Amount**
Balance as of December 31, 2013	3,986
Gain from change in fair value of warrant	(1,835)
Warrant exercise	(2,151)
Balance as of June 30, 2014	$

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

Items Measured at Fair Value on a Nonrecurring Basis

Certain assets, including our goodwill, are measured at fair value on a nonrecurring basis. These assets are recognized at fair value when they are deemed to be impaired. We did not consider any assets to be impaired during the three months ended June 30, 2014.

Note 8 Income Taxes

At June 30, 2014, the Company had no material unrecognized tax benefits and no adjustments to liabilities or operations were required under ASC 740, *Income Taxes* . The Company does not expect that the unrecognized tax benefits will materially increase within the next twelve months. The Company did not recognize any interest or penalties related to uncertain tax positions at June 30, 2014. The Company files United States federal income tax returns and income tax returns in various states and local jurisdictions. The Company s three preceding tax years remain subject to examination by federal and state taxing authorities. In addition, because the Company has net operating loss carry-forwards, the Internal Revenue Service and state jurisdictions are permitted to audit earlier years and propose adjustments up to the amount of net operating loss generated in those years. The Company is not under examination by any other federal or state jurisdiction for any tax years.

Note 9 Goodwill

In accordance with FASB Accounting Standards Codification (ASC) Topic 350-20, *Intangibles Goodwill and Other* , (ASC 350-20), the Company tests goodwill for impairment on an annual basis and between annual tests if events and circumstances indicate it is more likely than not that the fair value of the Company is less than the carrying value of the Company.

Factors the Company considers important, which could trigger an impairment of such asset, include the following:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner or use of the assets or the strategy for the Company s overall business;
- significant negative industry or economic trends;

significant decline in the Company s stock price for a sustained period; and

a decline in the Company s market capitalization below net book value.

The Company s CODM is the Chief Executive Officer (CEO). In the second quarter of 2013, the Company changed the manner in which financial information is reported to the CODM. The Company s reportable segments have been identified primarily based on the types of products sold. Each reportable segment generates revenue from the sale of medical equipment and related services and/or sale of supplies. The Company has determined there are two segments, Cancer Detection (Detection) and Cancer Therapy (Therapy). Goodwill was allocated to the reporting units based on the relative fair value of the reporting units as of June 2013.

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

The Company performed an annual impairment assessment at October 1, 2013 based on the new reporting structure and compared the fair value of each of reporting unit to its carrying value as of this date. Fair value of each reporting unit exceeded the carry value by approximately 362% for the Detection reporting unit and 179% for the Therapy reporting unit. The carrying values of the reporting units were determined based on an allocation of our assets and liabilities through specific allocation of certain assets and liabilities, to the reporting units and an apportionment based on the relative size of the reporting units revenues and operating expenses compared to the Company as a whole. The determination of reporting units also requires management judgment.

A rollforward of goodwill activity by reportable segment is as follows:

	Detection	Therapy	Total
Accumulated Goodwill	$	$	$ 47,937
Accumulated impairment			(26,828)
Fair value allocation	7,663	13,446	
Balance at December 31, 2013	7,663	13,446	21,109
Balance at June 30, 2014	$ 7,663	$ 13,446	$ 21,109

Note 10 Segment Reporting

In accordance with FASB Topic ASC 280, *Segments* , operating segments, are defined as components of an enterprise that engage in business activities for which discrete financial information is available and regularly reviewed by the chief operating decision maker (CODM) in deciding how to allocate resources and assess performance.

The Company has two reportable segments. The Detection segment consists of our advanced image analysis and workflow products, and the Therapy segment consists of our radiation therapy (Axxent) products. The primary factors used by our CODM to allocate resources are based on revenues, operating income or loss, and earnings or loss before interest, taxes, depreciation, amortization, and other specific and non-recurring items (Adjusted EBITDA) of each segment. Included in segment operating income are stock compensation, amortization of technology and depreciation expense. There are no intersegment revenues.

We do not track our assets by operating segment and our CODM does not use asset information by segment to allocate resources or make operating decisions.

20

Table of Contents

iCAD, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2014

Segment revenues, segment operating income or loss, and a reconciliation of segment operating income or loss to GAAP loss before income tax is as follows (including prior periods which have been presented for consistency):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Segment revenues:				
Detection	$ 4,832	$ 3,807	$ 9,007	$ 8,445
Therapy	4,835	3,905	9,180	7,197
Total revenue	$ 9,667	$ 7,712	$ 18,187	$ 15,642
Segment operating income (loss):				
Detection	$ 1,897	$ 1,052	$ 3,413	$ 2,626
Therapy	(140)	77	(368)	(153)
Segment operating income	$ 1,757	$ 1,129	$ 3,045	$ 2,473
General and administrative expenses	$ (1,923)	$ (1,602)	$ (3,671)	$ (3,274)
Interest expense	(614)	(834)	(1,431)	(1,660)
Gain (loss) on fair value of warrant	699	(571)	1,835	(140)
Loss on extinguishment of debt	(903)	0	(903)	0
Other income	12	6	16	12
Loss before income tax	$ (972)	$ (1,872)	$ (1,109)	$ (2,589)

Note 11 Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (ASU 2014-09), which amends ASC 605 Revenue Recognition and creates a new Topic 606 Revenue from Contracts with Customers. This update provides guidance on how an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Upon initial application, the provisions of this update are required to be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this update recognized at the date of initial application. This update also expands the disclosure requirements surrounding revenue recorded from contracts with customers. This update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. We are currently evaluating the effect of this update

on our financial statements and have not yet determined the method of initial application we will use.

Note 12 Subsequent Events

On July 15, 2014 (the Closing Date), the Company entered into two Asset Purchase Agreements, one with Radion, Inc., a Delaware corporation (Radion), the other with DermEbx, a Series of Radion Capital Partners, LLC, a Delaware limited liability company (DermEbx and, together with Radion, the Sellers). Pursuant to the Asset Purchase Agreement with DermEbx, the Company purchased substantially all of the assets of the DermEbx, including all of DermEbx s intellectual property and customer contracts. The Company paid to DermEbx the following consideration: (i) $1,600,000 in cash and (ii) the issuance to DermEbx of 600,000 restricted shares of the Company s common stock, $0.01 par value per share. The Company held back $500,000 of the DermEbx cash consideration for the purposes of a purchase price adjustment based on the working capital of DermEbx, which adjustment will be made 120 days after the Closing Date. The 600,000 restricted shares are subject to the following provisions; 25% shall be locked up until the date that is two trading days after the Company announces its fourth quarter 2014 earnings; 30% of the shares shall be locked up for a period of twenty-four (24) months from the date of the agreement; and 30% of the shares shall be locked up for a period of thirty-six (36) months from the date of the agreement. In addition the Company delivered the remaining 15% or 90,000 of the restricted shares to US Bank, N.A., as escrow agent, to be held in escrow for a period of eighteen (18) months pursuant to the terms of an escrow agreement. The 90,000 escrow shares will act as the source of payment for the indemnification of the Company by DermEbx under the DermEbx Asset Purchase Agreement.

Pursuant to the terms of the Asset Purchase Agreement with Radion (, the Company purchased substantially all of the assets of Radion, including all of Radion s intellectual property and customer contracts. The Company paid to Radion the following consideration: (i) $2,200,000 in cash and (ii) the issuance to Radion of 600,000 restricted shares of the Company s common stock. The 600,000 restricted shares are subject to the following provisions; 25% shall be locked up until the date that is two trading days after the Company announces its fourth quarter 2014 earnings; 30% of the shares shall be locked up for a period of twenty-four (24) months from the date of the agreement; and 30% of the shares shall be locked up for a period of thirty-six (36) months from the date of the agreement. In addition the Company delivered the remaining 15% or 90,000 of the restricted shares to US Bank, N.A., as escrow agent, to be held in escrow for a period of eighteen (18) months pursuant to the terms of an escrow agreement. The 90,000 escrow shares will act as the source of payment for the indemnification of the Company by Radion under the Radion Asset Purchase Agreement.

Prior to the acquisition, the Sellers represented one of the Company s significant customers in the Therapy segment. As of June 30, 2014, the Company had a balance of $1.5 million of outstanding accounts receivable and $0.5 million of deferred revenue. In addition, the Company recognized approximately $1.6 million of Therapy product revenue and approximately $0.5 million of Therapy service revenue, for a total of $2.1 million related to Sellers, in the six month period ended June 30, 2014. For the six months ended June 30 2013 the Company recognized approximately $972,000 of Therapy product revenue and $50,000 of Therapy service revenue, for a total of approximately $1.02 million.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995: Certain information included in this Item 2 and elsewhere in this Form 10-Q that are not historical facts contain forward looking statements that involve a number of known and unknown risks, uncertainties and other factors that could cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievement expressed or implied by such forward looking statements. These risks and uncertainties include, but are not limited to, uncertainty of future sales and expense levels, protection of patents and other proprietary rights, the impact of supply and manufacturing constraints or difficulties, regulatory changes and requirements applicable to our products, product market acceptance, possible technological obsolescence of products, increased competition, integration of the acquired businesses, the impact of litigation and/or government regulation, changes in Medicare reimbursement policies, competitive factors, the effects of a decline in the economy in markets served by the Company and other risks detailed in the Company s other filings with the Securities and Exchange Commission. The words believe , plan , intend , expect , estimate , anticipate , likely , seek , should , would , could and identify forward-looking statements. Readers are cautioned not to place undue reliance on those forward-looking statements, which speak only as of the date the statement was made.

Results of Operations

Overview

iCAD is an industry-leading provider of advanced image analysis, workflow solutions and radiation therapy solutions for the early identification and treatment of cancer. The Company reports in two segments Detection and Therapy.

The Company has grown primarily through acquisitions including CADx, Qualia Computing, CAD Sciences and Xoft to become a broad player in the oncology market.

In the Detection segment, our industry-leading solutions include advanced image analysis and workflow solutions that enable healthcare professionals to better serve patients by identifying pathologies and pinpointing the most prevalent cancers earlier, a comprehensive range of high-performance, upgradeable Computer-Aided Detection (CAD) systems and workflow solutions for mammography, Magnetic Resonance Imaging (MRI) and Computed Tomography CT.

The Company intends to continue the extension of its superior image analysis and clinical decision support solutions for mammography, MRI and CT imaging. iCAD believes that advances in digital imaging techniques should bolster its efforts to develop additional commercially viable CAD/advanced image analysis and workflow products.

In the Therapy segment the Company offers an isotope-free cancer treatment platform technology. The Xoft Electronic Brachytherapy System (Xoft eBx) can be used for the treatment of early- stage breast cancer, endometrial cancer, cervical cancer and skin cancer. We believe the Xoft eBx

Table of Contents

system platform indications represent strategic opportunities in the United States and International markets to offer differentiated treatment alternatives. In addition, the Xoft eBx system generates additional recurring revenue for the sale of consumables and related accessories which will continue to drive growth in this segment.

On July 15, 2014 (the Closing Date), the Company entered into two Asset Purchase Agreements, one with Radion, Inc., a Delaware corporation (Radion), the other with DermEbx, a Series of Radion Capital Partners, LLC, a Delaware limited liability company (DermEbx) and, together with Radion, the Sellers). Pursuant to the Asset Purchase Agreement with DermEbx, the Company purchased substantially all of the assets of the DermEbx, including all of DermEbx s intellectual property and customer contracts. The Company paid the following consideration: (i) $1,600,000 in cash and (ii) the issuance to DermEbx of 600,000 restricted shares of the Company s common stock, $0.01 par value per share. The Company held back $500,000 of the DermEbx cash consideration for the purposes of a purchase price adjustment based on the working capital of DermEbx, which adjustment will be made 120 days after the Closing Date. The 600,000 restricted shares are subject to the following provisions; 25% shall be locked up until the date that is two trading days after the Company announces its fourth quarter 2014 earnings; 30% of the shares shall be locked up for a period of twenty-four (24) months from the date of the agreement; and 30% of the shares shall be locked up for a period of thirty-six (36) months from the date of the agreement. In addition the Company delivered the remaining 15% or 90,000 of the restricted shares to US Bank, N.A., as escrow agent, to be held in escrow for a period of eighteen (18) months pursuant to the terms of an escrow agreement. The 90,000 escrow shares will act as the source of payment for the indemnification of the Company by DermEbx under the DermEbx Asset Purchase Agreement.

Pursuant to the terms of the Asset Purchase Agreement with Radion (, the Company purchased substantially all of the assets of Radion, including all of Radion s intellectual property and customer contracts. The Company paid the following consideration: (i) $2,200,000 in cash and (ii) the issuance to Radion of 600,000 restricted shares of the Company s common stock. The 600,000 restricted shares are subject to the following provisions; 25% shall be locked up until the date that is two trading days after the Company announces its fourth quarter 2014 earnings; 30% of the shares shall be locked up for a period of twenty-four (24) months from the date of the agreement; and 30% of the shares shall be locked up for a period of thirty-six (36) months from the date of the agreement. In addition the Company delivered the remaining 15% or 90,000 of the restricted shares to US Bank, N.A., as escrow agent, to be held in escrow for a period of eighteen (18) months pursuant to the terms of an escrow agreement. The 90,000 escrow shares will act as the source of payment for the indemnification of the Company by Radion under the Radion Asset Purchase Agreement.

Prior to the acquisition, the Sellers represented one of the Company s significant customers in the Therapy segment. As of June 30, 2014, the Company had a balance of $1.5 million of outstanding accounts receivable and $0.5 million of deferred revenue. In addition, the Company recognized approximately $1.6 million of Therapy product revenue and approximately $0.5 million of Therapy service revenue, for a total of $2.1 million related to Sellers, in the six month period ended June 30, 2014. For the six months ended June 30 2013 the Company recognized approximately $972,000 of Therapy product revenue and $50,000 of Therapy service revenue, for a total of approximately $1.02 million.

Table of Contents

The Company s headquarters are located in Nashua, New Hampshire, with manufacturing and contract manufacturing facilities in New Hampshire and Massachusetts and an operations, research, development, manufacturing and warehousing facility in San Jose, California.

Critical Accounting Policies

The Company s discussion and analysis of its financial condition, results of operations, and cash flows are based on the Company s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates these estimates, including those related to accounts receivable allowance, inventory valuation and obsolescence, intangible assets, income taxes, warranty obligations, contingencies and litigation. Additionally, the Company uses assumptions and estimates in calculations to determine stock-based compensation. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. For a comprehensive list of the Company s critical accounting policies, reference should be made to the Annual Report on Form 10-K for the year ended December 31, 2013 filed on March 3, 2014.

Table of Contents

Three months ended June 30, 2014 compared to the three months ended June 30, 2013

Revenue:

	Three months ended June 30,			
	2014	**2013**	**Change**	**% Change**
Detection revenue				
Products	$ 2,809	$ 1,647	$ 1,162	70.6%
Service and supplies	2,023	2,160	(137)	(6.3)%
Subtotal	4,832	3,807	1,025	26.9%
Therapy revenue				
Products	2,485	2,631	(146)	(5.5)%
Service and supplies	2,350	1,274	1,076	84.5%
Subtotal	4,835	3,905	930	23.8%
Total revenue	$ 9,667	$ 7,712	$ 1,955	25.4%

Three months ended June 30, 2014:

Total revenue for the three month period ended June 30, 2014 was $9.7 million compared with revenue of $7.7 million for the three month period ended June 30, 2013, an increase of approximately $2.0 million, or 25.4%. The increase in revenue was due to a $0.9 million increase in Therapy revenue and an increase in Detection revenues of approximately $1.0 million.

Detection product revenue increased by approximately $1.0 million from $3.8 million to $4.8 million or 26.9% in the three months ended June 30, 2014 as compared to the three months ended June 30, 2013. The increase is due primarily to an increase in our Digital CAD revenue of approximately $1.0 million driven by sales of our Powerlook AMP product and Volpara breast density assessment product.

Detection service and supplies revenue decreased approximately $137,000 from $2.2 million in the three months ended June 30, 2013 to $2.0 million in the three months ended June 30, 2014. Service and supplies revenue reflects the sale of service contracts to our installed base of customers. Service and supplies revenue related to our installed base of customers grew by approximately 7%, which was offset by lower time and materials and consulting revenue, which can vary from quarter to quarter.

Therapy product revenue was approximately $2.5 million for the three months ended June 30, 2014 as compared to $2.6 million for the three months ended June 30, 2013. Revenue from the sale of our Axxent eBx systems can vary due to an increase or decrease in the number of units sold which can cause a significant fluctuation in product revenue in the period. Product revenue for the three months ended June 30, 2014 consists primarily of sales for use in the treatment of non-melanoma skin cancers, with approximately two systems sold for use in intra-operative radiation therapy (IORT) market.

25

Table of Contents

Therapy service and supplies revenue increased approximately $1.1 million from $1.3 million in the three months ended June 30, 2013 to $2.4 million for the three months ended June 30, 2014. In March 2014, we reclassified certain applicator and accessory revenues that were previously a component of product revenue to service and supplies revenue. The prior period was adjusted for consistency of presentation. The increase in Therapy service and supplies revenue is due primarily to increases in service revenue due to the growing installed base and associated source and service agreement revenues combined with disposable applicators which are a result of increased procedure volumes. We expect service and supplies revenue for our electronic brachytherapy products to increase as patient treatment volume and our installed base of electronic brachytherapy systems increases.

In July 2014, we acquired DermEbx and Radion, each of which was a Therapy customer. For the three months ended June 30, 2014 we recognized approximately $838,000 of Therapy product revenue and approximately $275,000 of Therapy service and supplies revenue, for a total of $1.1 million related to these two customers. For the three months ended June 30, 2013 we recognized approximately $454,000 of Therapy product revenue and $38,000 of Therapy service and supplies revenue, for a total of approximately $492,000.

Gross Profit:

	Three months ended June 30,			
	2014	**2013**	**Change**	**% Change**
Products	$ 1,460	$ 1,193	$ 267	22.4%
Service & supply	$ 1,136	$ 1,063	73	6.9%
Amortization of acquired technology	$ 241	$ 234	7	3.0%
Total cost of revenue	$ 2,837	$ 2,490	$ 347	13.9%
Gross profit	$ 6,830	$ 5,222	$ 1,608	30.8%
Gross profit %	70.7%	67.7%		

Gross profit for the three month period ended June 30, 2014 was $6.8 million, or 71% of revenue as compared to $5.2 million or 68% of revenue in the three month period ended June 30, 2013. Gross profit percent changes primarily due to changes in the mix of business, consulting costs related to non-recurring engineering revenue, and additional manufacturing investments. Gross profit percent is also impacted by amortization of acquired technology, and the impact of the medical device excise tax which represented $200,000 for the three months ended June 30, 2014 as compared to $134,000 for the three months ended June 30, 2013. In March 2014, we reclassified certain applicator, accessory and other related cost of revenues that were previously a component of cost of product revenue to cost of service and supply revenue. The prior period was adjusted for consistency of presentation.

Table of Contents

Operating Expenses:

	Three months ended June 30,			
	2014	2013	Change	Change %
Operating expenses:				
Engineering and product development	$ 2,170	$ 1,756	$ 414	23.6%
Marketing and sales	2,903	2,337	566	24.2%
General and administrative	1,923	1,602	321	20.0%
Total operating expenses	$ 6,996	$ 5,695	$ 1,301	22.8%

Engineering and Product Development. Engineering and product development costs for the three month period ended June 30, 2014 increased by $0.4 million or 23.6%, from $1.8 million in 2013 to $2.2 million in 2014. Therapy Engineering and Product Development increased $0.2 million from $0.8 million in the three months ended June 30, 2013 as compared to $1.0 million for the three months ended June 30, 2014. The increase in Therapy Engineering and Product Development costs was due primarily to increases in salaries, and clinical and consulting costs. Detection Engineering and Product Development costs increased by $0.1 million from $1.0 million for the three months ended June 30, 2013 to $1.1 million for the three months ended June 30, 2014.

Marketing and Sales. Marketing and sales expenses increased by $0.6 million or 24.2%, from $2.3 million in the three month period ended June 30, 2013 to $2.9 million in the three month period ended June 30, 2014. Therapy Marketing and sales expense increased $0.6 million from $1.4 million in the three months ended June 30, 2013 to $2.0 million for the three months ended June 30, 2014. The increase in Therapy Marketing and Sales expenses was due primarily to increases in salaries and wages, consulting, trade shows and travel. These increases reflect continued investment in the Therapy segment. Detection Marketing and sales costs were $0.9 million for each of the three months ended June 30, 2014 and 2013.

General and Administrative. General and administrative expenses increased by $0.3 million from $1.6 million in the three month period ended June 30, 2013 to $1.9 million in the three month periods ended June 30, 2014. The increase in expense is due to approximately $0.2 million of legal, accounting and travel expense related to the acquisition.

Other Income and Expense:

	Three months ended June 30,			
	2014	2013	Change	Change %
Loss on extinguishment of debt	$ (903)	$	(903)	
Gain from change in fair value of warrants	699	(571)	1,270	(222.4)%
Interest expense	(614)	(834)	220	(26.4)%
Interest income	12	6	6	100.0%
	$ (806)	$ (1,399)	$ 593	(42.4)%
Tax expense	(25)	(10)	(15)	150.0%

Gain from change in fair value of warrants. The gain of $0.7 million and loss of $0.6 million from the change in fair value of the warrants for the periods ended June 30, 2014 and 2013, respectively, resulted from changes in the fair value of the warrants under the binomial lattice based valuation methodology, due primarily to a changes in the Company s stock price, and volatility which are

Table of Contents

the key assumptions in determining the value of the warrants. On April 30, 2014, the Warrants were exercised in full and the Company issued 450,000 shares of Common Stock. As a result of the extinguishment of the revenue purchase agreement, the Warrants to purchase an additional 100,000 shares of Common Stock were cancelled.

Interest expense. Interest expense of $614,000 decreased by $220,000 or 26.4% for the three month period ended June 30, 2014 as compared to interest expense of $834,000 in the three month period ended June 30, 2013. The reduction in interest expense is due primarily to the reduction in interest related to the Revenue Purchase agreement that was terminated in April 2014. Interest related to the Hologic and Zeiss settlement obligations was $54,000 in the three months ended June 30, 2014 as compared to $77,000 in the same period in 2013.

Interest income. Interest income of $12,000 and $6,000 for the three month periods ended June 30, 2014, and 2013, respectively, reflects income earned from our money market accounts.

Tax expense. Tax expense of $25,000 and $10,000 for the three month periods ended June 30, 2014, and 2013, respectively is due primarily to state non-income and franchise based taxes.

Six months ended June 30, 2014 compared to the Six months ended June 30, 2013

Revenue:

	Six months ended June 30,			
	2014	**2013**	**Change**	**% Change**
Detection revenue				
Products	$ 4,873	$ 4,320	$ 553	12.8%
Service and supplies	4,134	4,125	9	0.2%
Subtotal	9,007	8,445	562	6.7%
Therapy revenue				
Products	4,630	4,792	(162)	(3.4)%
Service and supplies	4,550	2,405	2,145	89.2%
Subtotal	9,180	7,197	1,983	27.6%
Total revenue	$ 18,187	$ 15,642	$ 2,545	16.3%

Six months ended June 30, 2014:

Total revenue for the six month period ended June 30, 2014 was $18.2 million compared with revenue of $15.6 million for the six month period ended June 30, 2013, an increase of approximately $2.5 million, or 16.3%. The increase in revenue was due to a $2.0 million increase in Therapy service and supplies revenue and an increase in total Detection revenues of approximately $0.5 million.

Detection product revenue increased by approximately $0.6 million from $4.3 million to $4.9 million or 12.8% in the six months ended June 30, 2013 as compared to the six months ended June 30, 2014. The increase is due primarily to an increase in our Digital CAD revenue of

28

Table of Contents

approximately $0.3 million a decrease in film based revenues of $0.2 million, and an increase in our MRI product revenues of $0.5 million. The decrease in Digital CAD revenue is driven by decreases in sales to our OEM partners. The increase in MRI product revenues reflects the success of our OEM partner in the MRI market.

Detection service and supplies revenue remained flat at approximately $4.1 million in the six months ended June 30, 2013 as compared to the six months ended June 30, 2014. Service and supplies revenue reflects the sale of service contracts as the result of our initiatives to sell into our installed base of customers.

Therapy product revenue decreased approximately $0.2 million from $4.8 million in the six months ended June 30, 2013 to $4.6 million for the six months ended June 30, 2014. Revenue from the sale of our Axxent eBx systems can vary due to an increase or decrease in the number of units sold which can cause a significant fluctuation in product revenue in the period. We continue to see interest in the Xoft solution primarily for its use in the treatment of non-melanoma skin cancers as well as the IORT market.

Therapy service and supplies revenue increased approximately $2.1 million from $2.4 million in the six months ended June 30, 2013 to $4.6 million for the six months ended June 30, 2014. In March 2014, we reclassified certain applicator and accessory revenues that were previously a component of product revenue to service and supplies revenue. The prior period was adjusted for consistency of presentation. The increase in Therapy service and supplies revenue is due primarily to increases in service and supplies revenue due to the growing installed base and associated source and service agreement revenues combined with disposable applicators which is a result of increased procedure volumes. We expect service and supplies revenue for our electronic brachytherapy products to increase as patient treatment volume and our installed base of electronic brachytherapy systems increases.

In July 2014, we acquired DermEbx and Radion, each of which was a Therapy customer. For the six months ended June 30, 2014 we recognized approximately $1.6 million of Therapy product revenue and approximately $0.5 million of Therapy service supplies revenue, for a total of $2.1 million related to these two customers. For the six months ended June 30, 2013 we recognized approximately $972,000 of Therapy product revenue and $50,000 of Therapy service and supplies revenue, for a total of approximately $1.02 million.

Gross Profit:

	Six months ended June 30,			
	2014	**2013**	**Change**	**% Change**
Products	$ 2,659	$ 2,355	$ 304	12.9%
Service & supply	2,282	1,950	332	17.0%
Amortization of acquired technology	482	467	15	3.2%
Total cost of revenue	$ 5,423	$ 4,772	$ 651	13.6%
Gross profit	$ 12,764	$ 10,870	$ 1,894	17.4%
Gross profit %	70.2%	69.5%		

Table of Contents

Gross profit for the six month period ended June 30, 2014 was $12.8 million, or 70.2% of revenue as compared to $10.9 million or 69.5% of revenue in the six month period ended June 30, 2013. Gross profit percent changes primarily due to changes in the mix of business, consulting costs related to non-recurring engineering revenue, and additional manufacturing investments. Gross profit percent is also impacted by amortization of acquired technology, and the impact of the medical device excise tax which represented $379,000 for the six months ended June 30, 2014 as compared to $271,000 for the six months ended June 30, 2013. In March 2014, we reclassified certain applicator, accessory and other related cost of revenues that were previously a component of cost of product revenue to cost of service and supplies revenue. The prior period was adjusted for consistency.

Operating Expenses:

	Six months ended June 30,			
	2014	2013	Change	Change %
Operating expenses:				
Engineering and product development	$ 4,197	$ 3,622	$ 575	15.9%
Marketing and sales	5,522	4,775	747	15.6%
General and administrative	3,671	3,274	397	12.1%
Total operating expenses	$ 13,390	$ 11,671	$ 1,719	14.7%

Engineering and Product Development. Engineering and product development costs for the six month period ended June 30, 2014 increased by $0.6 million or 15.9%, from $3.6 million in 2013 to $4.2 million in 2014. Therapy Engineering and Product Development increased $0.4 million from $1.6 million in the six months ended June 30, 2013 as compared to $2.0 million for the six months ended June 30, 2014. The increase in Therapy Engineering and Product Development costs was due primarily to increases in clinical and consulting costs. Detection Engineering and Product Development costs increased slightly by $0.1 million from $2.0 million for the six months ended June 30, 2013 to $2.1 million for the six months ended June 30, 2014.

Marketing and Sales. Marketing and sales expenses increased by $0.7 million or 15.6%, from $4.8 million in the six month period ended June 30, 2013 to $5.5 million in the six month period ended June 30, 2014. Therapy Marketing and sales expense increased $1.1 million from $2.7 million in the six months ended June 30, 2013 as compared to $3.8 million for the six months ended June 30, 2014. The increase in Therapy Marketing and Sales expenses was due primarily to increases in salaries and wages, consulting, trade shows and travel. These increases reflect continued investment in the Therapy segment. Detection Marketing and sales costs decreased by $0.3 million from $2.0 million for the six months ended June 30, 2013 to $1.7 million for the six months ended June 30, 2014, due primarily to decreases in salaries and wages.

General and Administrative. General and administrative expenses increased by $0.4 million or 12.1%, from $3.3 million in the six month period ended June 30, 2013 to $3.7 million in the six month period ended June 30, 2014. The increase in general and administrative expenses is due primarily to an increase of $0.2 million for legal, accounting and travel expenses related to the July 2014 acquisitions, and slight increases in legal, insurance and other administrative expenses.

Table of Contents

Other Income and Expense:

	Six months ended June 30,			
	2014	2013	Change	Change %
Loss on extinguishment of debt	$ (903)	$	(903)	
Loss from change in fair value of warrants	1,835	(140)	1,975	(1410.7)%
Interest expense	(1,431)	(1,660)	229	(13.8)%
Interest income	16	12	4	33.3%
	$ (483)	$ (1,788)	$ 1,305	(73.0)%
Tax expense	(78)	(20)	(58)	290.0%

Gain from change in fair value of warrants. The $1.8 million gain and $140,000 loss from the change in fair value of the warrants for the periods ended June 30, 2014 and 2013, respectively, resulted from changes in the fair value of the warrants under the binomial lattice based valuation methodology, due primarily to a changes in the Company s stock price versus the prior period, and volatility which are the key assumptions in determining the value of the warrants. On April 30, 2014, the Warrants were exercised in full and the Company issued 450,000 shares of Common Stock. As a result of the extinguishment of the revenue purchase agreement, the Warrants to purchase an additional 100,000 shares of Common Stock were cancelled.

Interest expense. Interest expense of $1.4 million decreased by $229,000 or 13.8% for the six month period ended June 30, 2014 as compared to interest expense of $1.7 million in the six month period ended June 30, 2013. The reduction in interest expense is due primarily to the reduction in interest related to the Revenue Purchase agreement that was terminated in April 2014. Interest related to the Hologic and Zeiss settlement obligations was $106,000 in the six months ended June 30, 2014 as compared to $152,000 in the same period in 2013.

Interest income. Interest income of $16,000 and $12,000 for the quarters ended June 30, 2014, and 2013, respectively, reflects income earned from our money market accounts.

Tax expense. Tax expense of $78,000 and $20,000 for the quarters ended June 30, 2014, and 2013, respectively is due primarily to state non-income and franchise based taxes.