

ICAD INC
Form 10-Q
November 04, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

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 001-09341

iCAD, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

02-0377419
(I.R.S. Employer
Identification No.)

98 Spit Brook Road, Suite 100, Nashua, NH
(Address of principal executive offices)
(603) 882-5200

03062
(Zip Code)

(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 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 NO .

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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

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

As of the close of business on November 3, 2015 there were 15,730,518 shares outstanding of the registrant's Common Stock, \$.01 par value.

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iCAD, Inc.

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Table of Contents**iCAD, INC. AND SUBSIDIARIES****Condensed Consolidated Balance Sheets**

(Unaudited)

(In thousands except for share data)

| | September 30, 2015 | December 31, 2014 |
|--|-------------------------------|------------------------------|
| <u>Assets</u> | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 17,536 | \$ 32,220 |
| Trade accounts receivable, net of allowance for doubtful accounts of \$377 in 2015 and \$203 in 2014 | 8,481 | 9,642 |
| Inventory, net | 3,746 | 2,214 |
| Prepaid expenses and other current assets | 684 | 540 |
| Total current assets | 30,447 | 44,616 |
| Property and equipment, net of accumulated depreciation of \$5,135 in 2015 and \$4,861 in 2014 | 2,605 | 4,255 |
| Other assets | 94 | 132 |
| Intangible assets, net of accumulated amortization of \$10,694 in 2015 and \$14,738 in 2014 | 4,473 | 17,504 |
| Goodwill | 14,198 | 27,263 |
| Total assets | \$ 51,817 | \$ 93,770 |
| <u>Liabilities and Stockholders' Equity</u> | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,557 | \$ 2,151 |
| Accrued and other expenses | 4,142 | 5,554 |
| Interest payable | | 180 |
| Notes and lease payable - current portion | 1,157 | 5,044 |
| Deferred revenue | 8,020 | 9,120 |
| Total current liabilities | 14,876 | 22,049 |
| Deferred revenue, long-term portion | 1,438 | 1,525 |
| Other long-term liabilities | 661 | 795 |
| Capital lease - long-term portion | 245 | 1,020 |
| Notes payable - long-term portion | | 5,602 |

| | | |
|--|-----------|-----------|
| Total liabilities | 17,220 | 30,991 |
| Commitments and Contingencies (Note 6 and 8) | | |
| 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 15,916,349 in 2015 and 15,732,177 in 2014; outstanding 15,730,518 in 2015 and 15,546,346 in 2014 | | |
| | 159 | 157 |
| Additional paid-in capital | 210,961 | 209,100 |
| Accumulated deficit | (175,108) | (145,063) |
| Treasury stock at cost, 185,831 shares in 2015 and 2014 | (1,415) | (1,415) |
| Total stockholders' equity | 34,597 | 62,779 |
| Total liabilities and stockholders' equity | \$ 51,817 | \$ 93,770 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**iCAD, INC. AND SUBSIDIARIES****Condensed Consolidated Statements of Operations**

(Unaudited)

(In thousands except for per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|---------------|--|----------------|
| | 2015 | 2014 | 2015 | 2014 |
| Revenue: | | | | |
| Products | \$ 4,515 | \$ 4,603 | \$ 11,569 | \$ 14,106 |
| Service and supplies | 5,067 | 7,969 | 22,376 | 16,653 |
| Total revenue | 9,582 | 12,572 | 33,945 | 30,759 |
| Cost of revenue: | | | | |
| Products | 1,110 | 1,019 | 2,731 | 3,589 |
| Service and supplies | 1,362 | 1,859 | 5,722 | 4,038 |
| Amortization and depreciation | 289 | 527 | 1,431 | 1,201 |
| Total cost of revenue | 2,761 | 3,405 | 9,884 | 8,828 |
| Gross profit | 6,821 | 9,167 | 24,061 | 21,931 |
| Operating expenses: | | | | |
| Engineering and product development | 2,093 | 2,086 | 6,621 | 5,952 |
| Marketing and sales | 2,697 | 3,448 | 9,692 | 8,912 |
| General and administrative | 2,118 | 2,282 | 6,661 | 5,836 |
| Amortization and depreciation | 257 | 425 | 1,373 | 931 |
| Goodwill and long-lived asset impairment | | | 27,443 | |
| Total operating expenses | 7,165 | 8,241 | 51,790 | 21,631 |
| Income (loss) from operations | (344) | 926 | (27,729) | 300 |
| Loss from extinguishment of debt | | | (1,723) | (903) |
| Gain from change in fair value of warrant | | | | 1,835 |
| Interest expense | (46) | (647) | (623) | (2,078) |
| Other income | 4 | 11 | 18 | 27 |
| Other expense, net | (42) | (636) | (2,328) | (1,119) |
| Income (loss) before income tax (expense) benefit | (386) | 290 | (30,057) | (819) |
| Tax (expense) benefit | (16) | (16) | 12 | (94) |

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| | | | | | | | | |
|--|----|--------|----|--------|----|----------|----|--------|
| Net income (loss) and comprehensive income (loss) | \$ | (402) | \$ | 274 | \$ | (30,045) | \$ | (913) |
| Net (loss) income per share: | | | | | | | | |
| Basic | \$ | (0.03) | \$ | 0.02 | \$ | (1.92) | \$ | (0.07) |
| Diluted | \$ | (0.03) | \$ | 0.02 | \$ | (1.92) | \$ | (0.07) |
| Weighted average number of shares used in computing loss (income) per share: | | | | | | | | |
| Basic | | 15,725 | | 15,283 | | 15,670 | | 13,609 |
| Diluted | | 15,725 | | 16,348 | | 15,670 | | 13,609 |

See accompanying notes to consolidated financial statements.

Table of Contents**iCAD, INC. AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows**

(unaudited)

**For the nine months ended
September 30,
2015 2014**
(in thousands)

| | | |
|---|---------------|------------|
| Cash flow from operating activities: | | |
| Net loss | \$ (30,045) | \$ (913) |
| Adjustments to reconcile net loss to net cash used for operating activities: | | |
| Amortization | 1,565 | 1,312 |
| Depreciation | 1,239 | 820 |
| Bad debt provision | 341 | 27 |
| Stock-based compensation expense | 1,601 | 966 |
| Amortization of debt discount and debt costs | 337 | 908 |
| Interest on settlement obligations | 124 | 161 |
| Loss on extinguishment of debt | 1,723 | 903 |
| Gain from change in fair value of warrant | | (1,835) |
| Goodwill and long-lived asset impairment | 27,443 | |
| Loss on disposal of assets | 125 | |
| Changes in operating assets and liabilities (net of the effect of acquisitions): | | |
| Accounts receivable | 821 | (2,665) |
| Inventory | (1,418) | (140) |
| Prepaid and other current assets | (197) | (26) |
| Accounts payable | (593) | (245) |
| Accrued expenses | (1,904) | 142 |
| Deferred revenue | (1,187) | 437 |
| Total adjustments | 30,020 | 765 |
| | | |
| Net cash used for operating activities | (25) | (148) |
| | | |
| Cash flow from investing activities: | | |
| Additions to patents, technology and other | (37) | (59) |
| Additions to property and equipment | (889) | (630) |
| Acquisition of Radion Inc, and DermEbx | | (3,482) |
| Acquisition of VuComp M-Vu Breast Density | (1,700) | |
| | | |
| Net cash used for investing activities | (2,626) | (4,171) |
| | | |
| Cash flow from financing activities: | | |

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| | | |
|--|-----------|-----------|
| Issuance of common stock for cash, net | | 28,214 |
| Stock option exercises | 349 | 616 |
| Warrant exercise | | 1,575 |
| Taxes paid related to restricted stock issuance | (87) | (110) |
| Principal payments of capital lease obligations | (1,045) | (313) |
| Principal repayment of debt financing, net | (11,250) | (4,100) |
| Net cash provided by (used for) financing activities | (12,033) | 25,882 |
| Increase (decrease) in cash and equivalents | (14,684) | 21,563 |
| Cash and equivalents, beginning of period | 32,220 | 11,880 |
| Cash and equivalents, end of period | \$ 17,536 | \$ 33,443 |
| Supplemental disclosure of cash flow information: | | |
| Interest paid | \$ 521 | \$ 1,343 |
| Taxes paid | \$ 101 | \$ 125 |
| Non-cash items from investing and financing activities: | | |
| Settlement of warrant liability with purchase of common stock | \$ | \$ 2,151 |
| Issuance of common stock related to acquisition of Radion, Inc and DermEbx | \$ | \$ 8,556 |

See accompanying notes to consolidated financial statements.

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iCAD, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

September 30, 2015

Note 1 - Basis of Presentation and Significant Accounting Policies

The accompanying condensed consolidated financial statements of iCAD, Inc. and subsidiaries (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 condensed consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the financial position of the Company at September 30, 2015, the results of operations of the Company for the three and nine month periods ended September 30, 2015 and 2014, and cash flows of the Company for the nine month periods ended September 30, 2015 and 2014. 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, 2014 filed with the SEC on March 13, 2015. The results for the three and nine month period ended September 30, 2015 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2015, 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 Arrangements (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 from 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 (BEBP). VSOE generally exists only when the deliverable is sold separately and is the price actually charged for that deliverable. The process for determining BEBP for deliverables without VSOE or TPE considers multiple factors

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iCAD, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

September 30, 2015

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.

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 revenue to 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 BEBP 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 BEBP, when delivered.

Revenue from certain CAD products is recognized in accordance with ASC 985-605. Sales of this product include training, and the Company has established VSOE for this element. Product revenue is determined based on the residual value in the arrangement and is recognized when delivered. Revenue for training is deferred and recognized when the training has been completed.

The Company recognizes post contract customer support revenue together with the initial licensing fee for certain MRI products in accordance with ASC 985-605-25-71.

Sales of the Company's Therapy segment products typically include a controller, accessories, source agreements and services. The Company allocates revenue to the deliverables in the arrangement based on the BEBP in accordance with ASU 2009-13.

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iCAD, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

September 30, 2015

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. The Company includes the following in service and supplies revenue: the sale of physics and management services, the lease of electronic brachytherapy equipment, development fees, supplies and the right to use the Company's AxxentHub software. Physics and management services revenue and development fees are considered to be delivered as the services are performed or over the estimated life of the agreement. The Company typically bills items monthly over the life of the agreement except for development fees, which are generally billed in advance or over a 12 month period and the fee for treatment supplies which is generally billed in advance.

The Company defers revenue from the sale of certain service contracts and recognizes the related 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.

Cost of Revenue

Cost of revenue consists of the costs of products purchased for resale, costs relating to service including personnel costs for physicists, management services and radiation therapists, 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, amortization, depreciation and in-house product warranty repairs.

Medical Device Excise tax included in the cost of revenue is approximately \$131,000 and \$462,000, for the three and nine months ended September 30, 2015, respectively and \$211,000 and \$590,000 for the three and nine months ended September 30, 2014, respectively.

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. The Therapy segment consists of our radiation therapy (Axxent) products, physics and management services, development fees, supplies, and the right to use the AxxentHub software platform.

Note 2 - 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 SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****September 30, 2015**

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|---------------|--|-----------------|
| | 2015 | 2014 | 2015 | 2014 |
| Net loss | \$ (402) | \$ 274 | \$ (30,045) | \$ (913) |
| Basic and diluted shares used in the calculation of net loss per share | 15,725 | 15,283 | 15,670 | 13,609 |
| Effect of dilutive securities: | | | | |
| Stock options | | 756 | | |
| Restricted stock | | 309 | | |
| Diluted shares used in the calculation of net loss per share | 15,725 | 16,348 | 15,670 | 13,609 |
| Net loss per share - basic and diluted | \$ (0.03) | \$ 0.02 | \$ (1.92) | \$ (0.07) |
| Net loss per share - diluted | \$ (0.03) | \$ 0.02 | \$ (1.92) | \$ (0.07) |

The shares of the Company's common stock, issuable upon the exercise of stock options 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:

| | Nine Months Ended September 30, | |
|------------------------------------|--|-------------|
| | 2015 | 2014 |
| Stock Options | 894,306 | 55,463 |
| Restricted Stock | 432,479 | |
| Stock options and restricted stock | 1,326,785 | 55,463 |

Note 3 Business Combinations

Acquisition of VuComp M-Vu Breast Density Product

On April 29, 2015, pursuant to the terms of the Asset Purchase Agreement with VuComp, the Company purchased VuComp's M-Vu Breast Density product for \$1,700,000 in cash. The Company considered the acquisition to be an acquisition of a business as the Company acquired the Breast Density product and certain customer liabilities which were considered to be an integrated set of activities at acquisition. Under the terms of the agreement, the Company acquired the breast density intellectual property product, which has been integrated with the Company's PowerLook Advanced Mammography Platform (AMP). PowerLook AMP is a modular solution designed to provide advanced tools for breast disease detection and analysis, including CAD for tomosynthesis. As the Company considered this to be a business combination, the assets were valued in accordance with ASC Topic 805, *Business Combinations* (ASC 805).

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The amount allocated to the acquired assets was estimated primarily through the use of discounted cash flow valuation techniques. Appraisal assumptions utilized under this method include a forecast of estimated future net cash flows, as well as discounting the future net cash flows to their present value. The acquired technology is being amortized over the estimated useful life of approximately eight years and nine months from the closing of the transaction. The following is a summary of the preliminary allocation of the total purchase price based on the estimated fair values as of the date of the acquisition and the amortizable life:

| | Amount | Estimated Amortizable Life |
|----------------------|----------|----------------------------|
| Developed Technology | 900 | 8 years 9 months |
| Goodwill | 800 | |
| Purchase price | \$ 1,700 | |

The assets obtained in the acquisition of VuComp's M-Vu Breast Density product and the anticipated future revenues are included in the Detection segment and, accordingly, the goodwill resulting from the purchase price allocation is included in goodwill of the Detection segment.

Acquisition of DermEbx and Radion

On July 15, 2014, the Company entered into two Asset Purchase Agreements, one with Radion, Inc. (Radion) the other with DermEbx, a series of Radion Capital Partners LLC (DermEbx) (the Radion/DermEbx Acquisition). Pursuant to the Asset Purchase Agreement with DermEbx, the Company purchased substantially all of the assets of DermEbx, including all of DermEbx's intellectual property and customer contracts. The Company paid the following consideration to DermEbx: (i) \$1,600,000 in cash and (ii) 600,000 restricted shares of the Company's common stock, \$0.01 par value per share. The 600,000 restricted shares were subject to the following provisions; 25% was locked up until the date that was two trading days after the Company announced its fourth quarter 2014 earnings, which occurred on March 2, 2015; 30% of the shares were to be locked up for a period of 24 months from the date of the agreement; and 30% of the shares were to be locked up for a period of 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, which were to be held in escrow for a period of 18 months pursuant to the terms of an escrow agreement. The 90,000 escrow shares acted as the source of payment for the indemnification of the Company by DermEbx under the DermEbx Asset Purchase Agreement. On October 7, 2015, the Company and each of Radion and DermEbx entered into a working capital settlement agreement pursuant to which the restrictions on the shares were lifted, the escrow shares were released from escrow and the parties agreed to settle all amounts owed under the Asset Purchase Agreements.

Table of Contents**iCAD, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****September 30, 2015**

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 to Radion: (i) \$2,382,000 in cash which included \$182,000 payoff of an existing note payable and (ii) the issuance to Radion of 600,000 restricted shares of the Company's common stock. The 600,000 restricted shares were subject to the following provisions; 25% of the shares were locked up until the date that was two trading days after the Company announces its fourth quarter 2014 earnings, which occurred on March 2, 2015; 30% of the shares shall be locked up for a period of 24 months from the date of the agreement; and 30% of the shares were to be locked up for a period of 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, which were to be held in escrow for a period of 18 months pursuant to the terms of an escrow agreement. The 90,000 escrow shares acted as the source of payment for the indemnification of the Company by Radion under the Radion Asset Purchase Agreement. On October 7, 2015, the Company and each of Radion and DermEbx entered into a working capital settlement agreement pursuant to which the restrictions on the shares were lifted, the escrow shares were released from escrow and the parties agreed to settle all amounts owed under the Asset Purchase Agreements.

Prior to the Radion DermEbx Acquisition in July 2014, the Sellers represented one of the Company's significant customers in the Therapy segment. The Company recognized approximately \$0.5 million of Therapy service revenue, for a total of \$2.1 million related to Sellers, in the six months ended June 30, 2014, and these amounts are included in the results for the nine months ended September 30, 2014.

The amounts allocated to purchased and developed software, customer relationships, trade names, employee non-compete agreements and backlog were estimated primarily through the use of discounted cash flow valuation techniques. Appraisal assumptions utilized under these methods include a forecast of estimated future net cash flows, as well as discounting the future net cash flows to their present value. Acquired intangible assets are being amortized over the estimated useful lives as set forth in the following table. The following is a summary of the 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 | Estimated Amortizable Life |
|--------------------------------|----------|----------------------------|
| Current assets | \$ 3,457 | |
| Property and equipment | 2,625 | 3 - 7 Years |
| Identifiable intangible assets | 6,050 | 5 - 10 Years |
| Goodwill | 6,270 | |
| Current liabilities | (4,382) | |
| Long-term liabilities | (2,164) | |

| | |
|----------------|-----------|
| Purchase price | \$ 11,856 |
|----------------|-----------|

Table of Contents**iCAD, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****September 30, 2015**

The assets obtained in the Radion/DermEbx Acquisition and the resulting revenues are included in the Therapy segment and, accordingly, the goodwill resulting from the purchase price allocation is included in goodwill of the Therapy segment. As discussed in Note 12, the Company recorded a goodwill impairment charge related to the Therapy segment of \$14.0 million in the quarter ended June 30, 2015.

The goodwill is deductible for income tax purposes.

Note 4 Inventory

The components of inventory, net of allowance for obsolete, unmarketable or slow-moving inventories, are summarized as follows:

| | as of September 30, 2015 | as of December 31, 2014 |
|-----------------|-------------------------------------|------------------------------------|
| Raw materials | \$ 2,488 | \$ 955 |
| Work in process | 161 | 54 |
| Finished Goods | 1,097 | 1,205 |
| Inventory | \$ 3,746 | \$ 2,214 |

Note 5 Long Term Debt

On March 31, 2015, the Company repaid in full the aggregate amount outstanding under the Deerfield Facility Agreement, dated as of December 29, 2011 (as amended, supplemented or otherwise modified to the date hereof, the Facility Agreement), by and among the Company, Deerfield Private Design Fund II, L.P., Deerfield Private Design International II, L.P., and Deerfield Special Situations Fund, L.P. and, for itself and as assignee of the obligations held by Deerfield Special Situations Fund International Master Fund, L.P. The Facility Agreement and related documents were terminated as of March 31, 2015. The Facility Agreement was to mature on December 29, 2016 and was able to be repaid prior to the maturity date at the Company's option without penalty or premium. On

Table of Contents**iCAD, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****September 30, 2015**

March 31, 2015, the Company used cash on hand to pay the \$11.25 million outstanding principal amount due under the Facility Agreement and approximately \$162,000 in accrued and unpaid interest on such principal amount.

The Company recorded a loss on the extinguishment of debt of approximately \$1.7 million at the termination date in the quarter ended March 31, 2015.

The following amounts compose interest expense included in our consolidated statement of operations for the three and nine months ended September 30, 2015 and 2014: (in thousands)

| | Three months ended September 30, | |
|--|----------------------------------|--------|
| | 2015 | 2014 |
| Cash interest expense | \$ | \$ 215 |
| Non-cash amortization of debt discount | | 327 |
| Amortization of debt costs | | 17 |
| Amortization of settlement obligations | 32 | 55 |
| Interest expense capital lease | 14 | 33 |
| Total interest expense | \$ 46 | \$ 647 |

| | Nine months ended September 30 | |
|--|--------------------------------|----------|
| | 2015 | 2014 |
| Cash interest expense | \$ 162 | \$ 1,009 |
| Non-cash amortization of debt discount | 254 | 775 |
| Amortization of debt costs | 13 | 93 |
| Amortization of settlement obligations | 124 | 161 |
| Interest expense capital lease | 70 | 40 |
| Total interest expense | \$ 623 | \$ 2,078 |

Cash interest expense represents the amount of interest paid in cash under the Facility Agreement which represents the interest of 5.75% on the Facility Agreement through March 31, 2015. 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 (see Note 8). Interest expense capital lease represents interest related to the capital lease as described in Note 6.

Table of Contents**iCAD, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****September 30, 2015****Note 6 Lease Commitments**Operating leases

Facilities are leased under operating leases expiring at various dates through September, 2017. Certain of these leases contain renewal options. Rent expense under operating leases was \$165,000 and \$490,000 for the three and nine month period ended September 30, 2015 and \$150,000 and \$476,000 for the three and nine month period ended September 30, 2014, respectively.

Future minimum lease payments as of September 30, 2015 under operating leases are as follows: (in thousands)

| Fiscal Year | Operating Leases |
|-------------|------------------|
| 2015 | \$ 128 |
| 2016 | 499 |
| 2017 | 255 |
| | \$ 882 |

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 whereby 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 is being depreciated over its useful life.

In connection with the Radion/DermEbx Acquisition, the Company assumed two separate equipment lease obligations with payments totaling approximately \$2.6 million through May 2017. The leases were determined to be capital leases and accordingly the equipment was capitalized and a liability of \$2.5 million was recorded. As of September 30, 2015, the outstanding liability for the acquired equipment leases was approximately \$1.4 million.

Future minimum lease payments under all outstanding capital leases are as follows: (in thousands)

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| Fiscal Year | Capital Leases |
|-----------------------------------|-------------------|
| 2015 | \$ 386 |
| 2016 | 1,039 |
| 2017 | 89 |
| Subtotal minimum lease obligation | 1,514 |
| Less interest | (112) |
| Total, net | 1,402 |
| Less current portion | (1,157) |
| Long term portion | \$ 245 |

Table of Contents**iCAD, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****September 30, 2015**

Kamal Gogineni is an employee of the Company's and a beneficial owner of more than 5% of the Company's common stock. Additionally, Mr. Gogineni is a significant shareholder of Radion Capital Partners (RCP). RCP was the lessor under a lease between RCP and DermEbx (the Lease). In connection with the Company's Radion/DermEbx acquisition that closed in July 2014, one of the assets and obligations that the Company acquired was the Lease. Pursuant to the Lease, the Company is obligated to pay a total of \$664,000 as of September 30, 2015 and the liability is included in the minimum lease payments above, with annual payments of \$192,000 for the remainder of 2015, \$396,000 in 2016 and \$76,000 in 2017.

Note 7 - Stock-Based Compensation

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

The Company granted 40,000 and 358,000 options in the three and nine months ended September 30, 2015. 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 | | Nine Months Ended | |
|---------------------------------|---------------------------|----------------|--------------------------|----------------|
| | September 30, | | September 30, | |
| | 2015 | 2014 | 2015 | 2014 |
| Average risk-free interest rate | 1.06% | 0.93% | 0.95% | 0.84% |
| Expected dividend yield | None | None | None | None |
| Expected life | 3.5 years | 3.5 years | 3.5 years | 3.5 years |
| Expected volatility | 74.6% | 66.3% to 69.3% | 60.5% to 74.6% | 64.2% to 69.3% |
| Weighted average exercise price | \$3.85 | \$8.74 | \$6.62 | \$8.02 |
| Weighted average fair value | \$2.02 | \$4.29 | \$3.19 | \$3.80 |

Table of Contents**iCAD, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****September 30, 2015**

The amounts included in the consolidated statement of operations relating to stock based compensation expense are as follows:

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2015 | 2014 | 2015 | 2014 |
| Cost of revenue | \$ 4 | \$ 3 | \$ 11 | \$ 10 |
| Engineering and product development | 53 | 43 | 165 | 126 |
| Marketing and sales | 162 | 97 | 495 | 237 |
| General and administrative | 318 | 217 | 930 | 593 |
| | \$ 537 | \$ 360 | \$ 1,601 | \$ 966 |

As of September 30, 2015 unrecognized compensation cost (in thousands) related to unexercisable options and unvested restricted stock and the weighted average remaining period is as follows:

| | |
|-----------------------|------------|
| Remaining expense | \$ 4,039 |
| Weighted average term | 1.21 years |

The Company's aggregate intrinsic value for stock options and restricted stock outstanding is as follows (in thousands):

| | Period Ended | |
|---------------------------|----------------------|-------------|
| | September 30, | |
| | 2015 | 2014 |
| Aggregate intrinsic value | | |
| Stock options | \$ 584 | \$ 7,448 |
| Restricted stock | 1,470 | 3,047 |

The intrinsic value of stock options exercised during the nine months ended September 30, 2015 and 2014 was \$0.3 million and \$0.9 million, respectively.

Note 8 - 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 September 30, 2015.

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iCAD, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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Settlement Obligations

In connection with the acquisition of Xoft in 2010, 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 Company has a liability within accrued expenses and long-term settlement cost for future payment and for future minimum royalty obligations totaling \$408,000. The Company recorded interest expense of approximately \$19,000 and \$55,000 in the three and nine months ended September 30, 2015 and \$27,000 and \$77,000 in the three and six months ended September 30, 2014, respectively, related to this obligation.

In December, 2011, the Company agreed to a settlement related to litigation with Carl Zeiss Meditec AG. The Company is obligated to pay the remaining amount of \$0.5 million in June 2017. As of September 30, 2015, the remaining liability recorded within accrued expenses and long-term settlement cost for future payment and for future minimum royalty obligations is \$408,000. The Company recorded interest expense of approximately \$13,000 and \$69,000 in the three and nine months ended September 30, 2015 and \$28,000 and \$84,000 in the three and nine months ended September 30, 2014, respectively, related to this obligation.

Other Commitments

The Company is obligated to pay approximately \$2.3 million for firm purchase obligations to suppliers for future product deliverables.

Litigation

The Company is a party to various legal proceedings and claims arising out of the ordinary course of its business. Although the final results of all such matters and claims cannot be predicted with certainty, the Company currently believes that there are no current proceedings or claims pending against it of which the ultimate resolution would have a material adverse effect on its financial condition or results of operations. However, should the Company fail to prevail in any legal matter or should several legal matters be resolved against the Company in the same reporting period, such matters could have a material adverse effect on our operating results and cash flows for that particular period. In all cases, at each reporting period, the Company evaluates whether or not a potential loss amount or a potential range of loss is probable and reasonably estimable under ASC 450, Contingencies. Legal costs are expensed as incurred.

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iCAD, INC. AND SUBSIDIARIES

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(Unaudited)

September 30, 2015

Note 9 - 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.

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. 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 Company's assets that are measured at fair value on a recurring basis relate to the Company's money market accounts.

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 the 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 \$) as of December 31, 2014

| | Level 1 | Level 2 | Level 3 | Total |
|-----------------------|------------------|----------------|----------------|------------------|
| Assets | | | | |
| Money market accounts | \$ 26,530 | \$ | \$ | \$ 26,530 |
| Total Assets | \$ 26,530 | \$ | \$ | \$ 26,530 |

Table of Contents**iCAD, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****September 30, 2015****Fair value measurements using: (000 s) as of September 30, 2015**

| | Level 1 | Level 2 | Level 3 | Total |
|-----------------------|------------------|----------------|----------------|------------------|
| Assets | | | | |
| Money market accounts | \$ 13,573 | \$ | \$ | \$ 13,573 |
| Total Assets | \$ 13,573 | \$ | \$ | \$ 13,573 |

Items Measured at Fair Value on a Nonrecurring Basis

Certain assets, including long-lived assets and goodwill, are measured at fair value on a nonrecurring basis. These assets are recognized at fair value when they are deemed to be impaired. The Company recorded a \$27.4 million impairment consisting of \$14.0 million related to goodwill and \$13.4 million related to long-lived assets as discussed in Note 11 and Note 12 and re-measured long-lived assets and goodwill of the Therapy reporting unit at fair value as of the impairment date as noted in the following table. The fair values of long-lived assets and goodwill were measured using Level 3 inputs.

Fair value measurements using: (000 s) as of September 30, 2015

| | Level 1 | Level 2 | Level 3 | Total |
|----------------------------------|----------------|----------------|-----------------|-----------------|
| Non-recurring assets | | | | |
| Long-lived and intangible assets | \$ | \$ | \$ 3,195 | \$ 3,195 |
| Goodwill | | | 5,735 | 5,735 |
| Total Assets | \$ | \$ | \$ 8,930 | \$ 8,930 |

Note 10 - Income Taxes

The Company recorded an income tax provision of \$16,000 and an income tax benefit of \$12,000, in the three and nine months ended September 30, 2015 as compared to a provision of \$16,000 and \$94,000 in the three and nine months ended September 30, 2014, respectively. The income tax provision for the three months ended September 30, 2015 relates primarily to state taxes. The income tax net benefit for the nine months ended September 30, 2015 primarily relates to a benefit from the reversal of a deferred tax liability relating to tax amortizable goodwill, offset by the state tax provision. Due to the Company's goodwill impairment the tax basis in amortizable goodwill is greater than book basis which results in a deferred tax asset that is subject to a valuation allowance. At September 30, 2015, the Company had no material unrecognized tax benefits and no adjustments to liabilities or tax expense 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 September 30, 2015. 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,

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iCAD, INC. AND SUBSIDIARIES

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(Unaudited)

September 30, 2015

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 federal or state jurisdiction for any tax years.

Note 11 Long-lived assets

In accordance with FASB ASC Topic 360, *Property, Plant and Equipment*, (ASC 360), the Company assesses long-lived assets for impairment if events and circumstances indicate it is more likely than not that the fair value of the asset group is less than the carrying value of the asset group.

ASC 360-10-35 uses *events and circumstances* criteria to determine when, if at all, an asset (or asset group) is evaluated for recoverability. Thus, there is no set interval or frequency for recoverability evaluation. In accordance with ASC 360-10-35-21 the following factors are examples of events or changes in circumstances that indicate the carrying amount of an asset (asset group) may not be recoverable and thus is to be evaluated for recoverability.

A significant decrease in the market price of a long-lived asset (asset group);

A significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition;

A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator;

An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset (asset group);

A current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group).

As a result of external factors and general uncertainty related to reimbursement for the treatment of non-melanoma skin cancer, the Company evaluated the long-lived assets of the Therapy segment and reviewed them for potential impairment. The Company determined the *Asset Group* to be the assets of the Therapy segment, which the Company

considered to be the lowest level for which the identifiable cash flows were largely independent of the cash flows of other assets and liabilities.

In accordance with ASC 360-10-35-17, if the carrying amount of an asset or asset group (in use or under development) is evaluated and found not to be fully recoverable (the carrying amount exceeds the estimated gross, undiscounted cash flows from use and disposition), then an impairment loss must be recognized. The impairment loss is measured as the excess of the carrying amount over the assets (or asset group s) fair value.

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iCAD, INC. AND SUBSIDIARIES

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(Unaudited)

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In connection with the preparation of the financial statements for the second quarter ended June 30, 2015, the Company completed its analysis pursuant to ASC 360-10-35-17 and determined that the carrying value of the Asset Group was approximately \$36.8 million, which exceeded the undiscounted cash flows by approximately \$2.8 million. Accordingly the Company completed the Step 2 analysis to determine the fair value of the asset group. The Company recorded long-lived asset impairment charges of approximately \$13.4 million in the second quarter ended June 30, 2015 and as a result the long lived assets in the asset group were recorded at their current fair values.

A considerable amount of judgment and assumptions are required in performing the impairment tests, principally in determining the fair value of the asset group and the reporting unit. While the Company believes the judgments and assumptions are reasonable, different assumptions could change the estimated fair values and, therefore additional impairment charges could be required. Significant negative industry or economic trends, disruptions to the Company's business, loss of significant customers, inability to effectively integrate acquired businesses, unexpected significant changes or planned changes in use of the assets may adversely impact the assumptions used in the fair value estimates and ultimately result in future impairment charges.

Note 12 - Goodwill

In accordance with FASB 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 Chief Operating Decision Maker (CODM) is the Chief Executive Officer (CEO). The two segments and reporting units are Cancer Detection (Detection) and Cancer Therapy (Therapy). Each segment generates revenue from the sale of medical equipment and related services and/or sale of supplies.

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iCAD, INC. AND SUBSIDIARIES

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(Unaudited)

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The Company performed the annual impairment assessment at October 1, 2014 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 315% for the Detection reporting unit and 255% 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 of the remaining net assets 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. The Company's next annual impairment assessment is October 1, 2015.

An impairment charge is recorded if such an assessment were to indicate that the fair value of a reporting unit was less than the carrying value. When the Company evaluates potential impairments outside of the annual measurement date, judgment is required in determining whether an event has occurred that may impair the value of goodwill or intangible assets. The Company utilizes either discounted cash flow models or other valuation models, such as comparative transactions and market multiples, to determine the fair value of the reporting unit. The Company makes assumptions about future cash flows, future operating plans, discount rates, comparable companies, market multiples, purchase price premiums and other factors in those models. Different assumptions and judgment determinations could yield different conclusions that would result in an impairment charge to income in the period that such change or determination was made.

As a result of external factors and general uncertainty related to reimbursement for non-melanoma skin cancer and in conjunction with the long-lived asset impairment testing, the Company performed an impairment assessment of the Therapy reporting unit as of June 30, 2015. As a result the Company recorded a goodwill impairment charge of \$14.0 million during the quarter ended June 30, 2015.

The implied fair value of the Therapy reporting unit was determined in the same manner as the manner in which the amount of goodwill recognized in a business combination is determined. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied amount of goodwill. The Company identified the intangible assets that were valued during this process, including technology, customer relationships, trade-names, and the Company's workforce. The allocation process was performed only for purposes of testing goodwill for impairment.

The Company determined the fair value of the Therapy reporting unit based on the present value of estimated future cash flows, discounted at an appropriate risk adjusted rate. This approach was selected as it measures the income producing assets, primarily technology and customer relationships. This method estimates the fair value based upon the ability to generate future cash flows, which is particularly applicable when future profit margins and growth are expected to vary significantly from historical operating results.

Table of Contents**iCAD, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****September 30, 2015**

The Company uses internal forecasts to estimate future cash flows and includes an estimate of long-term future growth rates based on the most recent views of the long-term forecast for the reporting unit. Accordingly, actual results can differ from those assumed in the forecasts. The discount rate of approximately 17% is derived from a capital asset pricing model and analyzing published rates for industries relevant to the reporting unit to estimate the cost of equity financing. The Company uses discount rates that are commensurate with the risks and uncertainty inherent in the respective businesses and in the internally developed forecasts.

Other significant assumptions include terminal value margin rates, future capital expenditures, and changes in future working capital requirements. While there are inherent uncertainties related to the assumptions used and to the application of these assumptions to this analysis, the income approach provides a reasonable estimate of the fair value of the Therapy reporting unit.

The Step 2 test resulted in an approximate fair value of goodwill of \$5.7 million which resulted in a goodwill impairment loss of \$14.0 million.

As discussed in Note 3, the Company acquired VuComp's M-Vu® Breast Density product for \$1.7 million. The product will be integrated into the Company's Powerlook AMP system, which is a component of the Detection reporting unit. The Company determined that the acquisition was a business combination and accordingly recorded goodwill of \$0.8 million.

A roll forward of goodwill activity by reporting unit is as follows:

| | Detection | Therapy | Total |
|--|-----------|----------|-----------|
| Accumulated Goodwill | \$ | \$ | \$ 47,937 |
| Accumulated impairment | | | (26,828) |
| Fair value allocation | 7,663 | 13,446 | |
| Acquisition of DermEbx and Radion | | 6,154 | 6,154 |
| Balance at December 31, 2014 | 7,663 | 19,600 | 27,263 |
| Acquisition measurement period adjustments | | 116 | 116 |
| Acquisition of VuComp | 800 | | 800 |
| Impairment | | (13,981) | (13,981) |
| Balance at September 30, 2015 | \$ 8,463 | \$ 5,735 | \$ 14,198 |

Note 13 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.

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iCAD, INC. AND SUBSIDIARIES

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September 30, 2015

The Company's CODM is the CEO. Each 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, Detection and Therapy.

The Detection segment consists of our advanced image analysis and workflow products, and the Therapy segment consists of our radiation therapy Axxent products, and related services. The primary factors used by our CODM to allocate resources are based on revenues, gross profit, operating income, 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.

Our CODM does not use asset information by segment to allocate resources or make operating decisions.

Table of Contents**iCAD, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****September 30, 2015**

Segment revenues, gross profit, segment operating income or loss, and a reconciliation of segment operating income or loss to GAAP loss before income tax is as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|------------|
| | 2015 | 2014 | 2015 | 2014 |
| Segment revenues: | | | | |
| Detection | \$ 5,202 | \$ 4,936 | \$ 14,945 | \$ 13,943 |
| Therapy | 4,380 | 7,636 | 19,000 | 16,816 |
| Total Revenue | \$ 9,582 | \$ 12,572 | \$ 33,945 | \$ 30,759 |
| Segment gross profit: | | | | |
| Detection | \$ 4,423 | \$ 4,102 | \$ 12,460 | \$ 11,426 |
| Therapy | 2,398 | 5,065 | 11,601 | 10,505 |
| Segment gross profit | \$ 6,821 | \$ 9,167 | \$ 24,061 | \$ 21,931 |
| Segment operating income (loss): | | | | |
| Detection | 2,392 | 2,142 | 6,185 | 5,555 |
| Therapy | (558) | 1,127 | (27,070) | 759 |
| Segment operating income | \$ 1,834 | \$ 3,269 | \$ (20,885) | \$ 6,314 |
| General, administrative, depreciation and amortization expense | | | | |
| General, administrative, depreciation and amortization expense | \$ (2,178) | \$ (2,343) | \$ (6,844) | \$ (6,014) |
| Interest expense | (46) | (647) | (623) | (2,078) |
| Gain on fair value of warrant | | 0 | | 1,835 |
| Other income | 4 | 11 | 18 | 27 |
| Loss on debt extinguishment | | | (1,723) | (903) |
| Loss before income tax | \$ (386) | \$ 290 | \$ (30,057) | \$ (819) |

Note 14 - 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. In April 2015 the FASB voted to defer the effective date of this standard to years beginning after December 15, 2017. 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.

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 delivers innovative cancer detection and radiation therapy solutions and services that enable clinicians to find and treat cancers earlier and while enhancing patient care. iCAD offers a comprehensive range of upgradeable computer aided detection (CAD) and workflow solutions to support rapid and accurate detection of breast, prostate and colorectal cancers. iCAD's Xoft® Axxent® Electronic Brachytherapy (eBx®) System® is a painless, non-invasive technology that delivers high dose rate, low energy radiation, which targets cancer while minimizing exposure to surrounding healthy tissue. The Xoft System is FDA cleared and CE marked for use anywhere in the body, including treatment of non-melanoma skin cancer, early-stage breast cancer and gynecological cancers. The comprehensive iCAD technology platforms include advanced hardware and software as well as management services designed to support cancer detection and radiation therapy treatments.

The Company has grown primarily through acquisitions including CADx, Qualia Computing, CAD Sciences, Xoft and DermEbx and Radion. The Radion/DermEbx acquisition extends the Company's position as a larger player in the oncology market, including the components that enable dermatologists and radiation oncologists to develop, launch and manage their electronic brachytherapy (eBx) programs for the treatment of non-melanoma skin cancer.

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).

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The Company intends to continue the extension of its image analysis and clinical decision support solutions for mammography, MRI and CT imaging. The Company believes that advances in digital imaging techniques, such as 3D mammography, should bolster its efforts to develop additional commercially viable CAD/advanced image analysis and workflow products. In April 2015, the Company acquired VuComp's M-Vu Breast Density product, which the Company expects to integrate with our mammography products. The purchase price was \$1.7 million which was paid in cash at closing.

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 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. With the acquisition of the assets of DermEbx and Radion, the Company offers solutions that enable dermatologists and radiation oncologists to develop, launch and manage their eBx programs for the treatment of non-melanoma skin cancer (NMSC).

In May 2015 the Company announced that one of the regional Medicare Administrative Contractors instructed physicians to report CPT code (17999) rather than the established CPT code (0182T) for electronic brachytherapy for treatment of NMSC. This announcement resulted in a significant disruption in our Therapy segment as a result of the reimbursement uncertainty. Revenues for the three and nine months ended September 30, 2015 were also negatively impacted as a result of the uncertainty. In addition, the Company implemented expense reductions in response to the general uncertainty with respect to reimbursement levels. The Company is proactively addressing the situation in its dialogue with the regional provider and Centers for Medicare and Medicaid Services (CMS); however there is insufficient clarification to fully assess the long-term impact on our customers.

As we have discussed in our risk factors noted in our Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2014, our business can be affected by coverage policies adopted by federal and state governmental authorities, such as Medicare and Medicaid, as well as private payers, which often follow the coverage policies of these public programs. Such policies may affect which products customers purchase and the prices customers are willing to pay for those products in a particular jurisdiction. The change in CPT codes for the Company's electronic brachytherapy treatment of NMSC had a negative impact on the Company's revenues for the nine months ended September 30, 2015.

In connection with the preparation of the financial statements for the second quarter ended June 30, 2015, the Company evaluated the Therapy reporting unit for both long-lived asset and goodwill impairment. As a result of this assessment, the Company recorded material impairment charges in our Therapy reporting unit (see Note 11 to our condensed consolidated financial statements for a further discussion).

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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, which now includes the operations of Xoft, Radion and DermEbx.

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, 2014 filed on March 13, 2015.

Table of Contents**Three months ended September 30, 2015 compared to the three months ended September 30, 2014****Revenue: (in thousands)**

| | Three months ended September 30, | | | |
|-------------------|----------------------------------|-----------|------------|----------|
| | 2015 | 2014 | Change | % Change |
| Detection revenue | | | | |
| Product revenue | \$ 3,230 | \$ 2,746 | \$ 484 | 17.6% |
| Service revenue | 1,972 | 2,190 | (218) | (10.0)% |
| Subtotal | 5,202 | 4,936 | 266 | 5.4% |
| Therapy revenue | | | | |
| Product revenue | 1,285 | 1,857 | (572) | (30.8)% |
| Service revenue | 3,095 | 5,779 | (2,684) | (46.4)% |
| Subtotal | 4,380 | 7,636 | (3,256) | (42.6)% |
| Total revenue | \$ 9,582 | \$ 12,572 | \$ (2,990) | (23.8)% |

Three months ended September 30, 2015 and 2014:

Total revenue for the three month period ended September 30, 2015 was \$9.6 million compared with revenue of \$12.6 million for the three month period ended September 30, 2014, a decrease of approximately \$3.0 million, or 23.8%. The decrease in revenue was due to a \$3.3 million decrease in Therapy revenue and an increase in Detection revenues of approximately \$0.3 million.

Detection product revenue increased by approximately \$0.5 million from \$2.7 million to \$3.2 million or 17.6% in the three months ended September 30, 2015 as compared to the three months ended September 30, 2014. The increase is due primarily to an increase in MRI revenue of approximately \$0.2 million and an increase in CAD revenue of \$0.3 million.

Detection service and supplies revenue decreased by approximately \$0.2 million from \$2.2 million in the three months ended September 30, 2014 to \$2.0 million in the three months ended September 30, 2015. 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 can vary from quarter to quarter.

Therapy product revenue was approximately \$1.3 million for the three months ended September 30, 2015 as compared to \$1.9 million for the three months ended September 30, 2014. Therapy product revenue for the three months ended September 30, 2015 was negatively impacted by customer reaction to the uncertainty of reimbursement rates in the United States. Revenue from the sale of our Axxent eBx systems can vary significantly due to an increase or decrease in the number of units sold which can cause a significant fluctuation in product revenue in the period.

Therapy service and supplies revenue decreased approximately \$2.7 million from \$5.8 million in the three months ended September 30, 2014 to \$3.1 million for the three months ended September 30, 2015. The decrease in Therapy

service and supplies revenue is due primarily to a decrease in the services related to electronic brachytherapy for NMSC, which is related to reimbursement uncertainty.

Table of Contents**Cost of Revenue and Gross Profit: (in thousands)**

| | Three months ended September 30, | | | |
|-------------------------------|---|-----------------|-------------------|-----------------|
| | 2015 | 2014 | Change | % Change |
| Products | \$ 1,110 | \$ 1,019 | \$ 91 | 8.9% |
| Service & supply | 1,362 | 1,859 | (497) | (26.7)% |
| Amortization and depreciation | 289 | 527 | (238) | (45.2)% |
| Total cost of revenue | \$ 2,761 | \$ 3,405 | \$ (644) | (18.9)% |
| Gross profit | \$ 6,821 | \$ 9,167 | \$ (2,346) | (25.6)% |
| Gross profit % | 71.2% | 72.9% | | |

| | Three months ended September 30, | | | |
|------------------------|---|--------------|----------------|-----------------|
| | 2015 | 2014 | Change | % Change |
| Detection gross profit | \$ 4,423 | \$ 4,102 | \$ 321 | 7.8% |
| Therapy gross profit | 2,398 | 5,065 | (2,667) | (52.7)% |
| Gross profit | 6,821 | 9,167 | (2,346) | (25.6)% |
| Gross profit % | 71.2% | 72.9% | | |

Gross profit for the three month period ended September 30, 2015 was \$6.8 million, or 71.2% of revenue as compared to \$9.2 million or 72.9% of revenue in the three month period ended September 30, 2014. Gross profit percent changes are primarily due to changes in the mix of business, consulting costs related to non-recurring engineering revenue, additional manufacturing investments and amortization of acquired intangibles.

Cost of products increased by approximately \$91,000 from approximately \$1.0 million for the three months ended September 30, 2014 to approximately \$1.1 million for the three months ended September 30, 2015, which is due primarily to the change in product mix in product revenue. The cost of product revenue as a percentage of product revenue was approximately 25% for the three months ended September 30, 2015 as compared to 22% for the three months ended September 30, 2014. Cost of product revenue can vary due to product mix.

The cost of service and supplies decreased by \$0.5 million from \$1.9 million in the three months ended September 30, 2014 to \$1.4 million in the three months ended September 30, 2015. The cost of service and supply revenue as a percentage of service and supply revenue was approximately 27% for the quarter ended September 30, 2015 and 22% for the quarter ended September 30, 2014. The decrease in cost of service supplies is due primarily to the decrease in service and supply revenue.

Amortization and depreciation decreased by \$238,000 from \$527,000 in three months ended September 30, 2014 to \$289,000 for the three months ended September 30, 2015. In June 2015, the Company impaired intangible

assets of the Therapy reporting unit and recorded amortization expense based on the revised values of the assets as a result amortization and depreciation for the intangibles decreased.

Table of Contents**Operating Expenses: (in thousands)**

| | Three months ended September 30, | | | |
|-------------------------------------|---|-----------------|-------------------|----------------|
| | 2015 | 2014 | Change | Change % |
| Operating expenses: | | | | |
| Engineering and product development | \$ 2,093 | \$ 2,086 | \$ 7 | 0.3% |
| Marketing and sales | 2,697 | 3,448 | (751) | (21.8)% |
| General and administrative | 2,118 | 2,282 | (164) | (7.2)% |
| Amortization and depreciation | 257 | 425 | (168) | (39.5)% |
| Total operating expenses | \$ 7,165 | \$ 8,241 | \$ (1,076) | (13.1)% |

Operating expenses decreased by approximately \$1.1 million or 13.1% in the three months ended September 30, 2015. During the second quarter of 2015, the Company implemented cost reduction initiatives, which impacted operating expenses in the third quarter of 2015.

Engineering and Product Development. Engineering and product development costs was \$2.1 million for each of the three month periods ended September 30, 2015 and September 30, 2014, and increased by \$7,000 or 0.3%. Therapy engineering and product development was \$1.1 million in each of the three months ended September 30, 2014 and September 30, 2015. Detection engineering and product development costs remained at approximately \$1.0 million for the three months ended September 30, 2014 and the three months ended September 30, 2015.

Marketing and Sales. Marketing and sales expenses decreased by \$0.8 million or 21.8%, from \$3.5 million in the three month period ended September 30, 2014 to \$2.7 million in the three month period ended September 30, 2015. Therapy marketing and sales expense decreased \$0.7 million from \$2.5 million in the three months ended September 30, 2014 to \$1.8 million for the three months ended September 30, 2015. The decrease in Therapy marketing and sales expenses was due primarily to decreases in salaries and wages and decreases in trade show costs, which vary from quarter to quarter. Detection marketing and sales costs decreased slightly by \$25,000 and were approximately \$0.9 million in each of the three months ended September 30, 2014 and September 30, 2015.

General and Administrative. General and administrative expenses decreased by \$164,000 from \$2.3 million in the three month period ended September 30, 2014 to \$2.1 million in the three month period ended September 30, 2015. The decrease was due primarily to a decrease in consulting costs as compared to the three month period ended September 2014 offset by increases in bad debt and stock compensation expense.

Amortization and Depreciation. Amortization and depreciation is primarily related to acquired intangible assets and depreciation related to machinery and equipment. Amortization and depreciation decreased by \$168,000 from \$425,000 in the three month period ended September 30,

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2014 to \$257,000 in the three month period ended September 30, 2015. In June 2015, the Company impaired intangible assets of the Therapy reporting unit and recorded amortization and depreciation expense based on the revised values of the assets. As a result, amortization and depreciation for the quarter ended September 30, 2015 decreased.

Other Income and Expense: (in thousands)

| | Three months ended September 30, | | | |
|------------------|---|---------|--------|----------|
| | 2015 | 2014 | Change | Change % |
| Interest expense | \$(46) | \$(647) | 601 | (92.9)% |
| Interest income | 4 | 11 | (7) | (63.6)% |
| | \$(42) | \$(636) | \$ 594 | (93.4)% |

Tax expense (16) (16) 0.0%

Interest expense. Interest expense of \$46,000 decreased by \$601,000 or 92.9% for the three month period ended September 30, 2015 as compared to interest expense of \$647,000 in the three month period ended September 30, 2014. The reduction in interest expense is due primarily to the reduction in interest related to the Deerfield facility agreement that was terminated in March 2015. Interest related to the Hologic and Zeiss settlement obligations was \$32,000 in the three months ended September 30, 2015 as compared to \$55,000 in the same period in 2014.

Interest income. Interest income of \$4,000 and \$11,000 for the three month periods ended September 30, 2015, and 2014, respectively, reflects income earned from our money market accounts.

Tax benefit (expense). Tax expense is due primarily to state non-income and franchise based taxes.

Table of Contents**Nine months ended September 30, 2015 compared to the nine months ended September 30, 2014****Revenue: (in thousands)**

| | Nine months ended September 30, | | | |
|--------------------------|---------------------------------|------------------|-----------------|--------------|
| | 2015 | 2014 | Change | % Change |
| Detection revenue | | | | |
| Product revenue | \$ 9,058 | \$ 7,619 | \$ 1,439 | 18.9% |
| Service revenue | 5,887 | 6,324 | (437) | (6.9)% |
| Subtotal | 14,945 | 13,943 | 1,002 | 7.2% |
| Therapy revenue | | | | |
| Product revenue | 2,511 | 6,487 | (3,976) | (61.3)% |
| Service revenue | 16,489 | 10,329 | 6,160 | 59.6% |
| Subtotal | 19,000 | 16,816 | 2,184 | 13.0% |
| Total revenue | \$ 33,945 | \$ 30,759 | \$ 3,186 | 10.4% |

Nine months ended September 30, 2015 and 2014:

Total revenue for the nine month period ended September 30, 2015 was \$33.9 million compared with revenue of \$30.8 million for the nine month period ended September 30, 2014, an increase of approximately \$3.2 million, or 10.4%. The increase in revenue was due to a \$2.2 million increase in Therapy revenue and an increase in Detection revenues of approximately \$1.0 million.

Detection product revenue increased by approximately \$1.4 million from \$7.6 million to \$9.1 million or 18.9% in the nine months ended September 30, 2015 as compared to the nine months ended September 30, 2014. The increase is due primarily to an increase in CAD revenue of approximately \$0.8 million and an increase in MRI revenue of \$1.0 million, offset by a decrease in analog products of \$0.3 million.

Detection service and supplies revenue decreased approximately \$0.4 million from \$6.3 million in the nine months ended September 30, 2014 to \$5.9 million in the nine months ended September 30, 2015. Service and supplies revenue reflects the sale of service contracts to our installed base of customers. The decrease in service and supplies revenue is due primarily to the decrease in OEM service contracts. Service and supplies revenue related to our installed base of customers can vary from quarter to quarter.

Therapy product revenue was approximately \$2.5 million for the nine months ended September 30, 2015 as compared to \$6.5 million for the nine months ended September 30, 2014. The decrease in product revenue was due primarily to the customer reaction to the uncertainty of reimbursement rates. Revenue from the sale of our Axxent eBx systems can vary significantly due to an increase or decrease in the number of units sold which can cause a significant fluctuation in product revenue in the period.

Therapy service and supplies revenue increased approximately \$6.2 million from \$10.3 million in the nine months ended September 30, 2014 to \$16.5 million for the nine months ended September 30, 2015. The increase in Therapy service and supplies revenue is due to additional revenues resulting from the acquisition of DermEbx and Radion as the acquisition occurred in July 2014. Revenues for the nine months ended September 30, 2015 were impacted by reimbursement uncertainty.

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In July 2014, we acquired the assets of DermEbx and Radion, each of which was a Therapy customer. Prior to the acquisition we recognized approximately \$1.6 million of Therapy product revenue and \$0.5 million of Therapy service and supplies revenue, for a total of approximately \$2.1 million, related specifically to these two customers, which are reflected in the results for the nine months ended September 30, 2014.

Cost of Revenue and Gross Profit: (in thousands)

| | Nine months ended September 30, | | | |
|-------------------------------|---------------------------------|-----------|----------|----------|
| | 2015 | 2014 | Change | % Change |
| Products | \$ 2,731 | \$ 3,589 | \$ (858) | (23.9)% |
| Service & supply | 5,722 | 4,038 | 1,684 | 41.7% |
| Amortization and depreciation | 1,431 | 1,201 | 230 | 19.2% |
| Total cost of revenue | \$ 9,884 | \$ 8,828 | \$ 1,056 | 12.0% |
| Gross profit | \$ 24,061 | \$ 21,931 | \$ 2,130 | 9.7% |
| Gross profit % | 70.9% | 71.3% | | |

| | Nine months ended September 30, | | | |
|------------------------|---------------------------------|-----------|----------|----------|
| | 2015 | 2014 | Change | % Change |
| Detection gross profit | \$ 12,460 | \$ 11,426 | \$ 1,034 | 9.0% |
| Therapy gross profit | 11,601 | 10,505 | 1,096 | 10.4% |
| Gross profit | 24,061 | 21,931 | 2,130 | 9.7% |

Gross profit % 70.9% 71.3%

Gross profit for the nine month period ended September 30, 2015 was \$24.1 million, or 70.9% of revenue as compared to \$22.0 million or 71.3% of revenue in the nine month period ended September 30, 2014. Gross profit percent changes are primarily due to changes in the mix of business, consulting costs related to non-recurring engineering revenue, additional manufacturing investments and amortization of acquired intangibles.

Cost of products decreased by approximately \$0.9 million from approximately \$3.6 million for the nine months ended September 30, 2014 to approximately \$2.7 million for the nine months ended September 30, 2015, which is due primarily to the overall decrease in product revenue. The cost of product revenue as a percentage of product revenue was approximately 24% for the nine months ended September 30, 2015 as compared to 25% for the nine months ended September 30, 2014. Cost of product revenue can vary due primarily to product mix.

The cost of service and supplies increased by \$1.7 million from \$4.0 million in the nine months ended September 30, 2014 to \$5.7 million in the nine months ended September 30, 2015. This increase is due primarily to the increase related to the acquisition of the assets of DermEbx and Radion and represents primarily personnel costs related to physics, radiation therapist and management services provided following the acquisition. The cost

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of service and supply revenue as a percentage of service revenue was approximately 26% in the quarters ended September 30, 2015 as compared to 24% for the quarter ended September 30, 2014.

Amortization and depreciation increased by \$0.2 million from \$1.2 million for the nine months ended September 30, 2014 to \$1.4 million for the nine months ended September 30, 2015. The increase in amortization and depreciation is due to amortization and depreciation for the acquired intangibles. In June 2015, the Company impaired intangible assets of the Therapy reporting unit and recorded amortization and depreciation expense based on the revised values of the assets.

Operating Expenses: (in thousands)

| | Nine months ended September 30, | | | |
|-------------------------------------|--|------------------|------------------|---------------|
| | 2015 | 2014 | Change | Change % |
| Operating expenses: | | | | |
| Engineering and product development | \$ 6,621 | \$ 5,952 | \$ 669 | 11.2% |
| Marketing and sales | 9,692 | 8,912 | 780 | 8.8% |
| General and administrative | 6,661 | 5,836 | 825 | 14.1% |
| Amortization and depreciation | 1,373 | 931 | 442 | 47.5% |
| Goodwill impairment | 27,443 | | 27,443 | 100.0% |
| Total operating expenses | \$ 51,790 | \$ 21,631 | \$ 30,159 | 139.4% |

Operating expenses increased by approximately \$30.1 million or 139.4%, in the nine months ended September 30, 2015. The primary driver for the increase was the goodwill and long-lived asset impairment as well as additional personnel costs related to the acquisition of DermEbx and Radion. In the second quarter of 2015, the Company implemented cost reduction initiatives, and these cost cutting initiatives are reflected in operating expenses in the nine months ended September 30, 2015.

Engineering and Product Development. Engineering and product development costs for the nine month period ended September 30, 2015 increased by \$0.7 million, or 11.2%, from \$6.0 million in 2014 to \$6.6 million in 2015. Therapy engineering and product development increased \$0.5 million from \$3.1 million in the nine months ended September 30, 2014 to \$3.6 million for the nine months ended September 30, 2015. The increase in Therapy engineering and product development costs was due primarily to increases in salaries, consulting and clinical costs. Detection engineering and product development costs increased by approximately \$0.2 million from \$2.8 million for the nine months ended September 30, 2014 to \$3.0 million for the nine months ended September 30, 2015.

Marketing and Sales. Marketing and sales expenses increased by \$0.8 million or 8.8%, from \$8.9 million in the nine month period ended September 30, 2014 to \$9.7 million in the nine month period ended September 30, 2015. Therapy marketing and sales expense increased \$0.5 million from \$6.3 million in the nine months ended September 30, 2014 to \$6.8 million for the nine months ended September 30, 2015. The increase in Therapy marketing and sales expenses was due primarily to increases in salaries and wages, consulting, trade shows and travel. For the nine months ended September 30, 2015, the Company incurred \$0.5 million of severance payments in

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the Therapy segment marketing and sales. Detection marketing and sales costs increased slightly by \$0.3 million from \$2.6 million in the nine months ended September 30, 2014 to \$2.9 million for the nine months ended September 30, 2015. This increase is due primarily to \$0.1 million of severance payments in the second quarter of 2015.

General and Administrative. General and administrative expenses increased by \$0.8 million from \$5.8 million in the nine month period ended September 30, 2014 to \$6.7 million in the nine month period ended September 30, 2015. The increase was due primarily to increases in personnel, legal, accounting, consulting, travel and stock compensation expense.

Amortization and Depreciation. Amortization and depreciation is primarily related to acquired intangible assets and depreciation related to machinery and equipment. Amortization and depreciation increased by \$0.4 million from \$0.9 million in the nine month period ended September 30, 2014 to \$1.4 million in the nine month period ended September 30, 2015. The increase in expense was due to amortization of the acquired intangible assets related to the DermEbX/ Radion acquisition. In June 2015, the Company impaired intangible assets of the Therapy reporting unit and recorded amortization and depreciation expense based on the revised values of the assets.

Goodwill and long-lived asset impairment. In connection with the preparation of the financial statements for the second quarter ended June 30, 2015, the Company evaluated the Therapy reporting unit for both long-lived asset and goodwill impairment and recorded an impairment charge of \$14.0 million related to goodwill and an impairment charge of \$13.4 related to long-lived assets for a total of \$27.4 million.

Other Income and Expense: (in thousands)

| | Nine months ended September 30, | | | |
|--|--|------------|------------|----------|
| | 2015 | 2014 | Change | Change % |
| Loss on extinguishment of debt | \$ (1,723) | \$ (903) | (820) | 90.8% |
| Loss from change in fair value of warrants | \$ | \$ 1,835 | (1,835) | (100.0)% |
| Interest expense | (623) | (2,078) | 1,455 | (70.0)% |
| Interest income | 18 | 27 | (9) | (33.3)% |
| | \$ (2,328) | \$ (1,119) | \$ (1,209) | 108.0% |
| Tax benefit (expense) | 12 | (94) | 106 | (112.8)% |

Loss on extinguishment of debt. The loss of \$1.7 million from the extinguishment of debt represents the loss associated with the payoff of the Deerfield facility agreement, which has now been terminated. On March 31, 2015, the Company paid \$11.25 million which represented the entire obligation. The loss on extinguishment represents the unamortized discount on the Facility agreement, and the write-off of the deferred debt costs. The Facility Agreement was to mature on December 29, 2016 and was able to be repaid at the Company's option without penalty or premium. The loss of \$0.9 million from the extinguishment of debt represents the loss associated with the payoff of the Deerfield revenue purchase agreement, which was terminated in April 2014.

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Gain from change in fair value of warrants. The gain of \$1.8 million from the change in fair value of the warrants for the period ended September 30, 2014, resulted from change in the fair value of the warrants under the binomial lattice based valuation methodology, due primarily to changes in the Company's stock price, 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.

Interest expense. Interest expense of \$0.6 million decreased by \$1.5 million or 70.0% for the nine month period ended September 30, 2015 as compared to interest expense of \$2.1 million in the nine month period ended September 30, 2014. The reduction in interest expense is due primarily to the reduction in interest related to the Deerfield facility agreement that was terminated on March 31, 2015. Interest related to the Hologic and Zeiss settlement obligations was \$124,000 in the nine months ended September 30, 2015 as compared to \$161,000 in the same period in 2014.

Interest income. Interest income of \$18,000 and \$27,000 for the nine month period ended September 30, 2015, and 2014, respectively, reflects income earned from our money market accounts.

Tax benefit (expense). The Company recorded a tax benefit of \$12,000 as compared to tax expense of \$94,000 for the nine month period ended September 30, 2015, and 2014, respectively. The tax benefit is due primarily to a deferred tax liability of approximately \$117,000, offset by tax expense of approximately \$105,000. The deferred liability was the result of tax amortizable goodwill that was recognized due to the impairment of goodwill. Tax expense is due primarily to state non-income and franchise based taxes.

Liquidity and Capital Resources

We believe that our current liquidity and capital resources are sufficient to sustain operations through at least the next 12 months, primarily due to cash on hand. Our projected cash needs include planned capital expenditures, lease and settlement commitments, and other long-term obligations.

As of September 30, 2015, the Company has current assets of \$30.4 million which includes \$17.5 of cash and cash equivalents. Current liabilities are \$14.9 million and working capital is \$15.6 million. The ratio of current assets to current liabilities was 2.04:1. On March 31, 2015 the Company paid \$11.3 million to repay the Deerfield facility agreement. In April 2015, we paid \$1.7 million to acquire VuComp's M-Vu Breast Density product which was paid in cash at closing.

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| | For the nine months ended September 30, | |
|--|--|-------------|
| | 2015 | 2014 |
| Net cash used for operating activities | \$ (25) | \$ (148) |
| Net cash used for investing activities | (2,626) | (4,171) |
| Net cash provided by (used for) financing activities | (12,033) | 25,882 |
| Increase (decrease) in cash and equivalents | \$ (14,684) | \$ 21,563 |

Net cash used for operating activities for the nine month period ended September 30, 2015 was \$25,000, compared to net cash used for operating activities of \$148,000 for the nine month period ended September 30, 2014. The cash used for operating activities for the nine month period ended September 30, 2015 resulted primarily from sources of cash due to working capital changes resulting from decreases in accounts receivable offset by an increase in inventory and decreases in accounts payable and accrued expenses. We expect that cash used for or provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, specifically the timing of when we recognize revenue, our accounts receivable collections and the timing of other payments.

The net cash used for investing activities for the nine month period ended September 30, 2015 was \$2.6 million; the Company used approximately \$0.9 million for purchases of property and equipment, and \$1.7 million to acquire VuComp M-Vu Breast Density software. Cash used for investing activities was \$4.2 million in the nine month period ended September 30, 2014. The Company paid approximately \$3.5 million of cash related to the acquisition of DermEbx and Radion in the quarter ended September 30, 2014, and used approximately \$0.7 million for purchases of purchases of property and equipment.

Net cash used for financing activities for the nine month period ended September 30, 2015 was \$12.0 million as compared to net cash provided by financing activities of \$25.8 million for the nine month period ended September 30, 2014. The net cash used for financing activities of \$12.0 million represents primarily the repayment of the Deerfield Facility Agreement of \$11.3 million and \$1.0 million for capital leases, offset by cash received of approximately \$0.3 million from stock option exercises. The cash provided by financing activities of \$25.9 million for the nine month period ended September 30, 2014 includes the underwritten offering in March 2014 of 2.76 million shares at approximately \$11.00 per share, with net proceeds of \$28.2 million after deducting offering expenses and underwriting discounts.

Table of Contents**Contractual Obligations**

The following table summarizes, for the periods presented, our future estimated cash payments under existing contractual obligations (in thousands).

| Contractual Obligations | Payments due by period | | | | |
|--------------------------------------|-------------------------------|-----------------------------|------------------|------------------|-----------------|
| | Total | Less than 1 year | 1-3 years | 3-5 years | 5+ years |
| Operating Lease Obligations | \$ 882 | \$ 502 | \$ 380 | \$ | \$ |
| Capital Lease Obligations | 1,402 | \$ 1,157 | 245 | | |
| Settlement Obligations | 1,425 | 275 | 800 | 50 | 300 |
| Other Commitments | 2,295 | 2,295 | | | |
| Total Contractual Obligations | \$ 6,004 | \$ 4,229 | \$ 1,425 | \$ 50 | \$ 300 |

Operating lease obligations are the minimum payments due under these obligations. Capital lease obligations represent the principal payments due under the respective leases.

Settlement obligations represent the minimum payments attributable to the obligations related primarily to Zeiss and Hologic.

Other commitments represent firm purchase obligations to suppliers for future product deliverables.

Recent Accounting Pronouncements

See Note 14 to the Condensed Consolidated Financial Statements.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

We believe we are not subject to material foreign currency exchange rate fluctuations, as substantially all of our sales and expenses are denominated in the U.S. dollar. We do not hold derivative securities and have not entered into contracts embedded with derivative instruments, such as foreign currency and interest rate swaps, options, forwards, futures, collars or warrants, either to hedge existing risks or for speculative purposes.

Item 4. Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, as of September 30, 2015, the principal executive officer and principal financial officer concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (Exchange Act)) were effective at the reasonable level of assurance.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. We conduct periodic evaluations to enhance, where necessary our procedures and controls.

Our principal executive officer and principal financial officer conducted an evaluation of our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) to determine whether any changes in internal control over financial reporting occurred during the quarter ended September 30, 2015, that have materially affected or which are reasonably likely to materially affect internal control over financial reporting. Based on that evaluation, there has been no such change during such period.

Table of Contents**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

Please refer to the detailed discussion regarding litigation set forth in Note 8 of the Notes to Condensed Consolidated Financial Statements in this Form 10-Q.

The Company is involved in various legal matters that are in the process of litigation or settled in the ordinary course of business. Although the final results of all such matters and claims cannot be predicted with certainty, we believe that the ultimate resolution of all such matters and claims will not have a material adverse effect on our financial condition. However, such matters could have a material adverse effect on our operating results and cash flows for a particular period.

Item 1A. Risk Factors:

We operate in a changing environment that involves numerous known and unknown risks and uncertainties that could materially adversely affect our operations. Our risk factors are described in Part I, Item 1A of our Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2014 as filed with the SEC on March 13, 2015. There have been no material changes in the risks affecting iCAD since the filing of our Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

| Month of purchase | Total number of shares purchased (1) | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum dollar value of shares that may yet be purchased under the plans or programs |
|----------------------------------|--------------------------------------|------------------------------|--|--|
| July 1 - July 31, 2015 | | | \$ | \$ |
| August 1 - August 31, 2015 | 1,028 | \$ 3.15 | \$ | \$ |
| September 1 - September 30, 2015 | | | \$ | \$ |
| Total | 1,028 | \$ 3.15 | \$ | \$ |

- (1) Represents shares of common stock surrendered by employees to the Company to pay employee withholding taxes due upon the vesting of restricted stock.

Item 6. Exhibits

| Exhibit No. | Description |
|----------------|--|
| 10.1 | Change of Control Bonus Agreement by and between the Company and Ken Ferry dated October 29, 2015. |
| 10.2 | Change of Control Bonus Agreement by and between the Company and Kevin Burns dated October 29, 2015. |

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- 10.3 Change of Control Bonus Agreement by and between the Company and Stacey Stevens dated October 29, 2015.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. *
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. *
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *
- 101 The following materials formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014, (ii) Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and 2014, (iii) Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2015 and 2014, and (iv) Notes to Consolidated Financial Statements.

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

iCAD, Inc.
(Registrant)

Date: November 4, 2015

By: /s/ Kenneth M. Ferry
Kenneth M. Ferry
Chief Executive Officer, Director

Date: November 4, 2015

By: /s/ Kevin C. Burns
Kevin C. Burns
President, Chief Operating Officer Chief Financial
Officer and Treasurer