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ICAD INC  
Form 8-K/A  
March 15, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K/A

CURRENT REPORT

Pursuant to Section 13 or 15 (d) of the  
Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): December 31, 2003  
-----

iCAD, INC.

-----  
(Exact name of registrant as specified in its charter)

Delaware	1-9341	02-0377419
-----	-----	-----
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

4 Townsend West, Suite 17, Nashua, NH 03063  
-----  
(Address of principal executive offices) (zip code)

Registrant's telephone number, including area code (603) 882-5200  
-----

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(Former name or former address, if changed since the last report)

ITEM 7. FINANCIAL STATEMENTS AND EXHIBITS

(a) Financial Statements of Business Acquired

Qualia Computing, Inc. and Subsidiaries

Fiscal Year ended March 31, 2003

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Nine Months Ended December 31, 2003

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(b) Pro forma financial information.

Unaudited Pro Forma Combined Condensed Balance Sheet as of September 30, 2003	PF1-PF2
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(c) Exhibits

23.1 Consent of Brady Ware & Schoenfeld, Inc.

QUALIA COMPUTING, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED MARCH 31, 2003

QUALIA COMPUTING, INC. AND SUBSIDIARIES

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Pushing the Possibilities

[BRADY WARE LOGO]

### INDEPENDENT AUDITORS'REPORT

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One South Main Street  
Suite 600  
Dayton, Ohio 45402  
(937) 223-5247  
(800) 893-4283  
Fax (937) 223-0300

Board of Directors  
Qualia Computing and Subsidiaries  
Beavercreek, Ohio

One Woodside Drive  
Richmond, Indiana 47374  
(765) 966-0531  
(800) 515-5536  
Fax (765) 962-5015

[www.bradyware.com](http://www.bradyware.com)

We have audited the accompanying consolidated balance sheet of QUALIA COMPUTING, Inc. and Subsidiaries as of March 31, 2003, and the related consolidated statements of operations, comprehensive loss, changes in stockholders' equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant

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estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Qualia Computing, Inc. and Subsidiaries as of March 31, 2003, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ BRADY WARE & SCHOENFELD, INC.

-----  
Dayton, Ohio  
August 26, 2003

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### QUALIA COMPUTING, INC. AND SUBSIDIARIES

#### CONSOLIDATED BALANCE SHEET

MARCH 31, 2003

-----  
ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$	2,339,669
Accounts receivable		2,632,643
Inventory		1,742,234
Prepaid expenses		213,602
Prepaid income taxes		64,250
Investments		256,729

-----  
7,249,127

PROPERTY AND EQUIPMENT, NET

1,020,956

OTHER ASSETS

565,449

-----  
\$ 8,835,532  
=====

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES

Accounts payable	\$	596,063
Accrued expenses		766,952

-----  
1,363,015  
-----

STOCKHOLDERS' EQUITY

Common stock		15
Cumulative translation adjustment		27,498

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Paid-in capital	36,260,994
Accumulated deficit	(28,817,326)
Accumulated other comprehensive income	1,336
	-----
	7,472,517
	-----
	\$ 8,835,532
	=====

See notes to financial statements. 2

QUALIA COMPUTING, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF OPERATIONS  
YEAR ENDED MARCH 31, 2003

NET SALES	\$ 5,092,340
COST OF SALES	2,216,179
	-----
GROSS MARGIN	2,876,161
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	9,829,308
	-----
LOSS FROM OPERATIONS	(6,953,147)
OTHER INCOME (EXPENSE) - NET	215,772
	-----
LOSS BEFORE INCOME TAXES	(6,737,375)
INCOME TAX EXPENSE	(8,759,473)
	-----
NET LOSS	\$ (15,496,848)
	=====

See notes to financial statements. 3

QUALIA COMPUTING, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS  
YEAR ENDED MARCH 31, 2003

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NET LOSS	\$ (15,496,848)
OTHER COMPREHENSIVE LOSS	
Unrealized gain on investment securities	163
	-----
COMPREHENSIVE LOSS	\$ (15,496,685)
	=====

See notes to financial statements. 4

QUAUA COMPUTING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

YEAR ENDED MARCH 31, 2003

	COMMON STOCK	PREFERRED STOCK	PREFERRED STOCK SUBSCRIBED	CUMULATIVE Translation Adjustments	PAID CAPITAL
	-----	-----	-----	-----	-----
Balance - March 31, 2002	\$ 8,470	\$ 193	\$ 1,350,000	\$ -	\$23,353
Net loss	-	-	-	-	
Sale of treasury stock	-	-	-	-	
Unrealized gain on investments	-	-	-	-	
Gain on translation of currency	-	-	-	37,200	
Issuance of 3,000 shares of common stock	-	-	-	-	3
Issuance of 1,350 preferred shares, previously subscribed	-	13	(1,350,000)	-	1,350
Issuance of 2,075 preferred shares	-	21	-	-	5,997
Recapitalization/acquisition of subsidiaries	(8,455)	(227)	-	(9,702)	5,556
	-----	-----	-----	-----	-----
Balance - March 31, 2003	\$ 15	\$ -	\$ -	\$ 27,498	\$36,260
	=====	=====	=====	=====	=====

TREASURY STOCK	ACCUMULATED OTHER COMPREHENSIVE INCOME	ACCUMULATED DEFICIT	TOTAL STOCKHOLDERS EQUITY (DEFICI
-----	-----	-----	-----

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Balance - March 31, 2002	\$ (350,000)	\$ 1,173	\$ (13,026,478)	\$ 11,337,2
Net loss	-	-	(15,496,848)	(15,496,8
Sale of treasury stock	350,000	-	(294,000)	56,0
Unrealized gain on investments	-	163	-	1
Gain on translation of currency	-	-	-	37,2
Issuance of 3,000 shares of common stock	-	-	-	3,0
Issuance of 1,350 preferred shares, previously subscribed	-	-	-	
Issuance of 2,075 preferred shares	-	-	-	5,997,2
Recapitalization/acquisition of subsidiaries	-	-	-	5,538,5
	-----	-----	-----	-----
Balance - March 31, 2003	\$ -	\$ 1,336	\$ (28,817,326)	\$ 7,472,5
	=====	=====	=====	=====

See notes to financial statements.

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QUALIA COMPUTING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

YEAR ENDED MARCH 31, 2003

OPERATING ACTIVITIES

Net loss	\$ (15,496,848)
Adjustments to reconcile net loss to not cash used by operating activities:	
Depreciation and amortization	419,393
Deferred income taxes	8,762,889
Cumulative translation adjustments	37,200
Inventory reserve	100,000
Allowance for doubtful accounts	930,000
	-----
	(5,247,366)
Changes in operating assets and liabilities:	
Accounts receivable	551,187
Inventory	328,219
Prepaid expenses	(63,538)
Other assets	(85,377)
Accounts payable	253,412
Accrued expenses	(7,404)
	-----
Net cash used by operating activities	(4,270,867)
	-----

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INVESTING ACTIVITIES	
Proceeds from sale of assets	14,282
Purchases of property and equipment	(389,164)
Purchase of investments	(7,528)
Inventory deposits	38,182
Note receivable - related party	(1,000,000)
Cash received in acquisition of subsidiaries	188,714
	-----
Net cash used by investing activities	(1,155,514)
	-----
FINANCING ACTIVITIES	
Issuance of common stock	3,000
Issuance of preferred stock	5,997,227
Sale of treasury stock	56,000
	-----
Net cash provided by financing activities	6,056,227
	-----
NET INCREASE IN CASH AND CASH EQUIVALENTS	629,846
CASH AND CASH EQUIVALENTS	
Beginning of year	1,709,823
	-----
End of year	\$ 2,339,669
	=====

See notes to financial statements.

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QUALIA COMPUTING, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A - COMPANY OPERATIONS AND FINANCIAL VIABILITY

QUALIA COMPUTING, INC. AND SUBSIDIARIES is a software research and development organization specializing in computer-aided intelligence amplification, with applications in the fields of human decision making, including computer-aided cancer detection, intelligent drug and vaccine discovery, text categorization and time-series prediction. The Company's market is global with its headquarters located in Dayton, Ohio. The Company incurred research and development costs of \$2,838,490 during the year.

During September 2002, Qualia Computing, Inc. acquired the subsidiaries of Cadx Systems, Inc (Cadx USA), Cadx Medical Systems Inc (Cadx Canada), Cadx Medical Systems Limited (Cadx Ireland), and Cadx Medical Systems SARL (Cadx France) in exchange for giving Cadx Canada Inc. (owned by Shire Pharmaceuticals) 138,164 additional Qualia Computing, Inc. class B shares to bring their total ownership to 50%. The operations of the subsidiaries is being reported from September 26, 2002 through March 31, 2003.

Prior to the recapitalization of the capital (See Note M), the Company had been funding its operations with the sale of preferred shares of stock to Cadx Canada Inc. (Shire Pharmaceuticals). This capital was to be used to finance operations



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until an investor could be found to acquire Shire's shares- As of the date of these financial statements, investors have been found and negotiations are taking place. (See Note Q). As part of the acquisition of these shares, the investors intend to contribute \$10 million in cash to finance operations.

### NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**PRINCIPLES OF CONSOLIDATION** - The accompanying consolidated financial statements include the accounts of Qualia Computing, Inc. and its wholly owned subsidiaries, Cadx Systems, Inc (Cadx USA), Cadx Medical Systems Inc (Cadx: Canada), Cadx Medical Systems Limited (Cadx Ireland), and Cadx Medical Systems SARL (Cadx France). All significant inter-company transactions and balances have been eliminated in the accompanying consolidated financial statements.

**FINANCIAL ESTIMATES** - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**REVENUE RECOGNITION** - Sales revenue is recognized at the time title changes. A technician installs the unit after shipment, however, the cost associated with the installation is de minimis. Contract service revenue is recognized over the life of the contract. The unearned revenue is accounted for in the balance sheet account, "deferred revenue."

**CONCENTRATIONS** - Financial instruments that potentially subject the Company to credit risk consist principally of trade accounts receivable. In addition, from time to time, the Company has funds on deposit with a financial institution in excess of FDIC insurance limits.

**ACCOUNTS RECEIVABLE** - The Company uses the allowance method for receivables. An allowance for doubtful accounts is established to give recognition to the receivable amounts that may become uncollectible in the future. The allowance is reviewed annually to determine that the amount is appropriate. The allowance for the year ended March 31, 2003 was \$100,000.

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### QUALIA COMPUTING, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

**INVENTORIES** - Inventories are valued at the lower of cost (first-in, first-out method) or market. An Inventory reserve of \$100,000 has been set up as of March 31, 2003 to account for future obsolescence.

**PROPERTY AND EQUIPMENT** - PROPERTY and equipment are stated at cost and depreciated over their estimated useful lives using both straight-line and accelerated methods. Routine repairs and maintenance are charged to expense when incurred. Renewals and betterments which substantially increase the life of the property and equipment are capitalized. At retirement or sale, the costs of the assets, less related accumulated depreciation or amortization, are removed from the accounts and resulting gains and losses are included in income.

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INVESTMENTS - The Company classifies its marketable equity securities as available for sale. Securities classified as available for sale are carried in the financial statements at fair value. Realized gains and losses, determined using the first-in, first-out (FIFO) method, are included in earnings. Unrealized holding gains and losses are reported in other comprehensive income.

CASH EQUIVALENTS - Cash equivalents include amounts in money market funds and financial instruments with a maturity of less than three months at the date of purchase.

PATENTS - The costs associated with the registration of new patents are being amortized over a period of 15 years. The amortization expense for the year ended March 31, 2003 was \$15,274.

INCOME TAXES - The Company utilizes the asset and liability approach to accounting for income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for temporary differences between the financial reporting and the tax bases of the Company's assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

ADVERTISING EXPENSE - ADVERTISING costs are expensed as incurred. Advertising expense was \$280,468 for the year ended March 31, 2003.

### NOTE C - ACCOUNTS RECEIVABLE

Trade	\$	2,553,201
Employees		36,002
Miscellaneous		43,440
		-----
	\$	2,632,643
		=====

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### QUALIA COMPUTING, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE D - INVENTORY

Finished goods	\$	1,308,214
Parts		534,020
Inventory reserve		(100,000)
		-----
	\$	1,742,234
		=====

### NOTE E - INVESTMENTS

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The following table reflects the cost and estimated fair values of equity securities held at March 31, 2003. In addition, gross unrealized gains and losses are disclosed as of March 31, 2003.

	COST	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	-----	-----	-----	-----
Equity securities	\$ 255,393	\$ 1,336	\$ -	\$ 256,729
	=====	=====	=====	=====

Realized gains and losses for securities classified as available-for-sale are reported in earnings based on the adjusted cost of the specific security sold. There were no sales of securities for the year ended March 31, 2003.

NOTE F - PROPERTY AND EQUIPMENT

Leasehold improvements	\$ 54,431
Furniture, fixtures, and equipment	423,401
Computer equipment	171,828
Research equipment	1,344,348
Software	263,678
	-----
Total cost	2,257,686
Less accumulated depreciation and amortization	1,236,730
	-----
	\$ 1,020,956
	=====

NOTE G - OTHER ASSETS

Deposits	\$ 166,007
Cash surrender value of life insurance	13,501
Patent cost	253,677
Accumulated amortization - patents	(37,736)
Note receivable - related party	170,000
	-----
	\$ 565,449
	=====

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QUALIA COMPUTING, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The note receivable of \$1,000,000 as of March 31, 2003 is due in full on December 31, 2007, Interest is being charged at the prime rate as identified by the bank (4-25% as of March 31, 2003) and is due annually on August 21, the anniversary date of the note. An allowance for doubtful accounts of \$830,000 has been recorded against this note as of March 31, 2003.

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NOTE H - ACCRUED EXPENSES

Wages, bonuses, and commissions	\$	311,204
Vacation		92,966
Payroll taxes		66,306
401 K and profit sharing		132,588
Personal property, sales, and other miscellaneous taxes		14,788
Warranty reserve		140,600
Deferred revenue		8,500
		-----
	\$	766,952
		=====

The Second Look machines are under warranty for one year. The warranty reserve is based on the costs to cover the labor and the travel costs associated with the warranty service. All parts are under manufactures warranty for a year.

NOTE I - OPERATING LEASES

The Company leases its facilities for \$32,960 per month, The lease expires in December 2010. The Company is also responsible for utilities, real estate taxes, common area maintenance, cleaning and security. The lease amount increases annually throughout the life of the lease. The lease may be renewed for two additional terms of five years each. In connection with this lease, the Company is paying an additional \$1,727 per month for additional build out costs incurred by the lessor for the Company.

The Company also leases additional equipment and storage space as needed during the year.

The lease expense for the year ended March 31, 2003 was \$524,784.

Future minimum lease payments are as follows:

2004	\$	419,212
2005		431,166
2006		438,298
2007		435,438
2008		448,501
Thereafter		1,302,600
		-----
	\$	3,475,215
		=====

QUALIA COMPUTING, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE J - RELATED PARTY TRANSACTIONS

During the year, the Company engaged non-employee stockholders in consulting

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agreements to perform work on behalf of the Company. The total consulting fees paid under these agreements was \$228,487 for the year ended March 31, 2003.

The Company has a note receivable due from a related party in the amount of \$1,000,000 at March 31, 2003 (see Note G). An allowance for doubtful accounts of \$830,000 has been recorded against this note as of March 31, 2003.

### NOTE K - 401 (K) PLAN

The Company sponsors a contributory defined contribution pension plan as defined by IRS Code Section 401(k). All employees who have attained 21 years of age are eligible to participate in the plan. The Company will match 50% of the first 6% of each employee's wages deferred. An employee is vested in these matching and discretionary funds on a schedule of 20% each year until fully vested after completing five years of service with the Company. At the discretion of the board of directors, the Company may make discretionary contributions to the plan. Total matching and discretionary contributions made by the Company for the year ended March 31, 2003 amounted to \$312,073.

### NOTE L - INCOME TAXES

The Company provides income taxes on items included in the statement of operations regardless of the period when such taxes were payable. Deferred income taxes result from timing differences in the recognition of income and expense for tax and financial statement purposes.

Income tax expense differs from the amount currently payable because income is reported in the statement of operations in periods which differed from those in which they were subject to taxation. These timing differences result principally from net operating loss carryforwards and research and development credit carryforwards. The differences between income tax expense and taxes currently payable are reflected in deferred tax accounts in the balance sheets.

The Income tax provision consists of the following:

Current federal tax benefit	\$ (3,416)
Deferred federal tax benefit	(2,772,044)
Net change in valuation allowance	11,534,933
	-----
Income tax expense	\$ 8,759,473
	=====

Components of the deferred tax accounts are as follows:

Total long-term deferred tax assets	11,534,933
Net change in valuation allowance	(11,534,933)
	-----
Net deferred tax asset	\$ -
	=====

The Company has loss carryforwards totaling \$25,897,482 that may be offset against future taxable income, which expire beginning in 2013 through 2023. The Company has research tax credits totaling \$1,461,298

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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#### NOTE L - INCOME TAXES - CONTINUED

which expire beginning in 2013 through 2023. The Company also has a capital loss carryforward totaling \$3,644 that may be offset against future capital gains, If not used, the capital loss carryforward will expire in 2004. The deferred tax asset increased to \$11,534,933 in 2003 because of additional net operating loss carryforwards and research credits. Management now believes it is more likely than not that the deferred tax asset will not be realized due to ownership changes which could limit the loss carryforwards available. Accordingly, in 2003, a valuation allowance of \$11,534,933 was provided through charges of \$11,534,933 to the deferred tax provision.

#### NOTE M - STOCKHOLDERS' EQUITY

On September 26, 2002, Qualia Computing entered into a recapitalization agreement with Cadx Canada Inc. (owned by Shire Pharmaceuticals) to restructure the capital of the Company. In the recapitalization. two classes of common shares were defined, Class A and Class B. Cadx Canada Inc. owned all the preferred shares of Qualia Computing, Inc, prior to the recapitalization. These preferred shares were exchanged 1 for 1 for Class B common shares at the recapitalization. At the recapitalization, Qualia Computing, Inc. acquired the subsidiaries of Cadx Systems, Inc (Cadx USA), Cadx Medical Systems Inc (Cadx Canada), Cadx Medical Systems Limited (Cadx Ireland), and Cadx Medical Systems SARL (Cadx France) in exchange for giving Cadx Canada Inc. 138,164 additional Qualia Computing, Inc. Class B shares to bring their total ownership to 50%. The investment in the subsidiaries was recorded at the fair market value of the net assets at the time of the recapitalization.

As of March 31, 2003, the following shares of stock were authorized, issued and outstanding:

	Authorized	IS&W	Outstanding
	-----	-----	-----
Common shares (Class A, \$.0001 par value)	1,905,554	730,000	730,000
Common shares (Class B \$.0001 par value)	952,777	730,000	730,000

Class A and B shares have voting rights and are entitled to receive dividends pro rata. Class B shares shall upon a triggering event, be converted without cost into class A shares. Also, upon a triggering event, all stock options exercisable into Class B shares shall be converted automatically into the right to exercise Class A shares. A triggering event shall include a merger, consolidation, reorganization, recapitalization, or any sale, lease, assignment or transfer of all or substantially all assets of the Company.

#### NOTE N - STOCK OPTIONS

The Company initiated a stock option plan approved by the stockholders in February 2001. All options issued to date vest in equal installments over a period of four years with the first installment beginning twelve months following the date of grant. The compensation committee, as delegated by the board, determines the vesting schedule of the options. Prior to September 2002, the term of each option could not exceed ten years from the date of the grant of the option. During September 2002, the plan was amended to have no expiration date. The number of shares of Class A shares available for options is 222,777. The number of shares of Class B shares available for options is

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222,777. The option plan does not allow the issuance of options in an aggregate amount that would result in the outstanding options being greater than 10% of the total number of Class A and B shares outstanding at the time of the option grant.

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QUALIA COMPUTING, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE N - STOCK OPTIONS - CONTINUED

Stock option activity is presented as follows:

	Optioned Shares (Class A)	Option Price per Share	Total
Balance, March 31, 2002	50,700	\$ 1.00	\$ 50,700
Options issued	74,600	1.00	74,600
Balance, March 31, 2003	125,300	1.00	\$ 125,300

The Company did not record an expense for the options issued during the year. If the Company had used fair value based method of accounting for its employee stock option plan, as prescribed by Statement of Financial Accounting Standards No. 123, compensation cost in net loss for the year ended March 31, 2003 would have increased by \$74,600 with a corresponding increase in paid-in capital. Net loss for the year ended March 31, 2003 would have been \$15,571,448.

NOTE O - SPIN OFF

Qualia Financial Services, LLC was spun off from Qualia Computing, Inc. August 21, 2002. Hardware and software, along with cash of \$500,000 and licensed technology for use in online commodities trading of NASDAQ 100 and S & P 500 futures were transferred from Qualia Computing, Inc. in exchange for a promissory note for \$1,000,000. See Note G.

NOTE P - CONTINGENCIES

The Company is involved in a lawsuit with another company over patent infringement. The case has not been settled and no amounts have been accrued as of the date of these financial statements,

NOTE Q - SUBSEQUENT EVENTS

The shareholder who owns the Class B shares is currently in negotiations with individuals concerning the purchase of these Class 8 shares. A letter of intent has been signed as of the date of this report. As part of the purchase of these shares, these individuals intend to contribute cash of approximately \$10 million to the Company.

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The Company has signed agreements with GE to distribute the digital and analog digital products and with Source One to distribute the analog products. With the completion of these two agreements, it is the Company's intent to use distributors as the primary sales vehicle, however, the Company has retained the right to execute direct sales activities as necessary to achieve revenue targets.

One of the subsidiaries, Cadx France, is in the process of being dissolved. Any remaining assets after dissolution will be retained by the parent. No estimates can be made as to the effect of this item on the financial statements.

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### QUALIA COMPUTING, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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##### NOTE R - FOREIGN CURRENCY ITEMS

Cadx Canada, Cadx France and Cadx Ireland transacted a portion of their business using foreign currency. The transactions have been recorded in accordance with FASB 52 using the current rate of exchange, as applicable, on the transaction date. Gains or losses from the settlement of the foreign currency transactions are reported in other income (expense), as applicable on the payment date.

Foreign currency losses amounting to \$7,593 have been reported in the other income (expense) for the year ended March 31, 2003.

Cadx Canada, Cadx France, and Cadx Ireland use foreign currency as their functional currency. Translation adjustments result from the process of translating those entities' financial statements into the reporting currency of Qualia Computing. In accordance with FASB 52, those translation adjustments are not included in determining net income but are reported separately and accumulated in a separate component of equity called cumulative translation adjustments.

##### NOTE S - SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid during the year for

Interest paid	\$	185
		=====

Non cash investing and financing activities:

Acquisition of subsidiaries

Cash received	\$	188,714
Accounts receivable		3,104,649
Inventory		2,315,899
Property and equipment		480,852
Other assets		35,901
Accounts payable assumed		(46,447)
Accrued expenses assumed		(532,382)
Cumulated translation adjustment		9,702
Equity		(5,556,888)
		-----

Cash paid to acquire the subsidiaries	\$	-
		=====



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INDEPENDENT AUDITORS' REPORT ON CONSOLIDATED  
SUPPLEMENTARY INFORMATION

One South Main Street  
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Dayton, Ohio 45402  
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(800) 893-4283  
Fax (937) 223-0300

Board of Directors  
QUALIA COMPUTING, INC. AND SUBSIDIARIES  
Beavercreek, Ohio

One Woodside Drive  
Richmond, Indiana 47374  
(765) 966-0531  
(800) 515-5536  
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Our report on our audit of the basic financial statements of QUALIA COMPUTING, INC. AND SUBSIDIARIES as of March 31, 2003 appears on page one. Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information (shown on page 16) is presented for purposes of additional analysis of the financial statements rather than to present the consolidated balance sheet, results of operations and cash flows of the Company. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion is fairly stated in all material respects in relation to the financial statements taken as a whole for the year ended March 31, 2003.

/s/ BRADY WARE & SCHOENFELD, INC.

Dayton, Ohio  
August 26, 2003

QUAUA COMPUTING, INC. AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

YEAR ENDED MARCH 31, 2003

Wages	4,416,604
Bonuses	208,045
Payroll taxes	337,795
Employee benefits	433,173
401 (k) match and profit sharing	312,073
Bank charges	7,239
Computer supplies	47,166

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Repair and maintenance	26,195
Consulting fees	490,770
Legal and professional fees	737,785
Meals and entertainment	146,632
Contributions	25,250
Travel	710,971
Training and seminars	28,941
Office expense	63,443
Postage and freight	126,245
Rent	524,784
Research	12,406
Dues and subscriptions	27,852
Advertising	280,468
Depreciation expense	404,119
Amortization expense	15,274
Insurance	75,660
Miscellaneous taxes	56,074
Telephone and utilities	120,461
Personal property taxes	(5,007)
Licenses	37,511
Tuition assistance	11,407
Bad Debt	930,000
Relocation expense	19,252
Expenses allocated to cost of sales	(799,280)
	-----
	\$ 9,829,308
	=====

See independent auditors' report on consolidated supplementary information. 16

QUALIA COMPUTING, INC. AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
NINE MONTHS ENDED DECEMBER 31, 2003

QUALIA COMPUTING, INC. AND SUBSIDIARIES

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Consolidated Schedule of Selling, General and Administrative Expenses

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INDEPENDENT AUDITORS'REPORT

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We have audited the accompanying consolidated balance sheet of QUALIA COMPUTING, INC. and Subsidiaries as of December 31, 2003, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the nine months then ended. These consolidated financial statements are the responsibility of the Company's management. our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Qualia Computing, Inc. and Subsidiaries as of December 31, 2003, and the results of its operations and its cash flows for the nine months then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ BRADY WARE & SCHOENFELD, INC

-----  
Dayton, Ohio  
February 3, 2004

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### QUALIA COMPUTING, INC. AND SUBSIDIARIES

#### CONSOLIDATED BALANCE SHEET

DECEMBER 31, 2003

#### ASSETS

##### CURRENT ASSETS

Cash and cash equivalents	\$	446,031
Accounts receivable		2,479,089
Inventory		1,457,636
Prepaid expenses		63,523
		-----
		4,446,279

PROPERTY AND EQUIPMENT, NET 850,241

OTHER ASSETS 634,592

-----  
\$ 5,931,112

#### LIABILITIES AND STOCKHOLDERS' EQUITY

##### CURRENT LIABILITIES

Accounts payable	\$	2,722,133
Accrued expenses		1,156,678
		-----
		3,878,811
		-----

##### STOCKHOLDERS' EQUITY

Common stock		17
Cumulative translation adjustments		95,043
Paid-in capital		36,488,492
Accumulated deficit		(34,531,251)
		-----
		2,052,301
		-----
	\$	5,931,112

=====

See notes to financial statements. 2

QUALIA COMPUTING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

NINE MONTHS ENDED DECEMBER 31, 2003

-----

NETSALES	\$ 10,325,256
COST OF SALES	4,990,485
GROSS MARGIN	----- 5,334,771
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	10,813,972
LOSS FROM OPERATIONS	----- (5,479,201)
OTHER INCOME (EXPENSE) - NET	(234,724)
LOSS BEFORE INCOME TAXES	(5,713,925)
INCOME TAX EXPENSE	----- -
NET LOSS	----- \$ (5,713.92 =====

See notes to financial statements. 3

QUALIA COMPUTING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

NINE MONTHS ENDED DECEMBER 31, 2003

-----

	COMMON STOCK	TRANSLATION ADJUSTMENT	PAID-IN CAPITAL	OTHER COMPREHENSIVE INCOME (LOSS)
	-----	-----	-----	-----
Balance - April 1, 2003	\$ 15	\$ 27,498	\$ 36,260,994	\$ 1,336

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Net loss	-	-	-	-
Unrealized loss on investments	-	-	-	(1,336)
Gain on translation of currency	-	67,545	-	-
Stock options exercised	\$ 2	-	227,498	-
Balance - December 31, 2003	\$ 17	\$ 95,043	\$ 36,488,492	\$ -

See notes to financial statements.

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QUALIA COMPUTING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

NINE MONTHS ENDED DECEMBER 31, 2003

OPERATING ACTIVITIES

Net loss	\$ (5,713,925)
Adjustments to reconcile net loss to net cash used by operating activities:	
Depreciation and amortization	309,721
Loss on disposal of assets	164,325
Loss on sale of investments	5,545
Cumulative translation adjustments	67,545
Change in inventory reserve	1,054,163
Change in allowance for doubtful accounts	271,557
	(3,841,069)
Changes in operating assets and liabilities:	
Accounts receivable	(118,003)
Inventory	(933,065)
Prepaid expenses	214,329
Other assets	(84,372)
Accounts payable	2,126,070
Accrued expenses	389,726
Net cash used by operating activities	(2,246-384)

INVESTING ACTIVITIES

Purchases of property and equipment	(178,485)
Proceeds from sale of investments	256,410
Purchase of investments	(6,564)
Net cash provided by Investing activities	71,361

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### FINANCING ACTIVITIES

Issuance of common stock	227,500
	-----
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,947,523)
CASH AND CASH EQUIVALENTS	
Beginning of period	2,339,669
	-----
End of period	\$ 446,031
	=====

See notes to financial statements,

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### QUALIA COMPUTING, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

##### NOTE A - COMPANY OPERATIONS AND FINANCIAL VIABILITY

QUALIA COMPUTING, INC. AND SUBSIDIARIES (the "Company") is a software research and development organization specializing in computer-aided intelligence amplification, with applications in the fields of human decision-making, including computer-aided cancer detection, intelligent drug and vaccine discovery, text categorization and time-series prediction. The Company's market is global with its headquarters located in Dayton, Ohio. The Company incurred research and development costs of \$1,896,896 during the period.

On December 31, 2003, Qualia Computing, Inc, was acquired through a stock purchase by iCad, a Delaware corporation which develops, engineers, and manufactures CAD products in the medical imaging and women's health markets. Qualia Computing, Inc. was merged into Qualia Acquisition Corp., a wholly owned subsidiary of iCad. As a result of the merger, shares of Qualia class A and B common stock were deemed cancelled and converted into shares of iCad common stock, except for class B shares owned by CadX Canada, Inc. (Shire Pharmaceuticals) and class A shares owned by Brianna Biotech, Inc., who received cash and notes in lieu of iCad stock. These consolidated financial statements have been prepared on a basis consistent with prior years and do not reflect any adjustments from the application of purchase accounting.

Since inception, the Company had been funding its operations with the sale of preferred shares of stock to Cadx: Canada Inc. (Shire Pharmaceuticals). As described above, the Company has merged with iCad on December 31, 2003. The principal stockholder of iCad has indicated that he will continue to supply the necessary working capital to enable the Company to continue as a going concern.

##### NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION - The accompanying consolidated financial statements include the accounts of Qualia Computing, Inc. and its wholly owned subsidiaries, Cadx: Systems, Inc (Cadx USA), Cadx Medical Systems, Inc (Cadx Canada), Cadx Medical Systems Limited (Cadx Ireland), and Cadx Medical Systems SARL (Cadx France). All significant inter-company transactions and balances have been eliminated in the accompanying consolidated financial statements. Qualia Computing, Inc., the parent, has a March fiscal tax year end. The subsidiaries all have December tax year ends.

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FINANCIAL ESTIMATES - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

REVENUE RECOGNITION - Sales revenue on units that are sold through a distributor is recognized upon shipment to the distributor. The distributor has responsibility for installation. The Company is providing training after installation on Source One contracts and on GE contracts of analog units; however, the cost of this training is de minimus and insignificant to the overall sale transaction. Sales revenue on units sold directly by the Company is recognized upon installation. Contract service revenue is recognized over the life of the contract. The unearned revenue is accounted for in the balance sheet account, "unearned revenue."

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QUALIA COMPUTING, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

NOTE 8 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

CONCENTRATIONS - Financial instruments that potentially subject the Company to credit risk consist principally of trade accounts receivable. In addition, from time to time, the Company has funds on deposit with a financial institution in excess of FDIC insurance limits.

ACCOUNTS RECEIVABLE - The Company uses the allowance method in accounting for bad debts. An allowance for doubtful accounts is established to give recognition to the receivable amounts that may become uncollectible in the future. The allowance is reviewed annually to determine that the amount is appropriate. The allowance as of December 31, 2003 was \$1,400.

INVENTORIES - Inventories are valued at the lower of cost (first-in, first-out method) or market. An inventory reserve of \$1,154,163 has been set up as of December 31, 2003 to account for obsolescence. The inventory reserve increased by \$1,054,163 for the nine months ended December 31, 2003. This accounts for approximately 21 % of the cost of sales for the nine months ended December 31, 2003.

PROPERTY AND EQUIPMENT - Property and equipment are stated at cost and depreciated over their estimated useful lives using both straight-line and accelerated methods. Routine repairs and maintenance are charged to expense when incurred. Renewals and betterments which substantially increase the life of the property and equipment are capitalized. At retirement or sale, the costs of the assets, less related accumulated depreciation or amortization, are removed from the accounts and resulting gains and losses are included in income.

PATENTS - The costs associated with the registration of patents are being amortized over a period of 15 years on a straight-line method. The amortization expense for the nine months ended December 31, 2003 was \$15,229.



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INCOME TAXES - The Company utilizes the asset and liability approach to accounting for income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for temporary differences between the financial reporting and the tax basis of the Company's assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

ADVERTISING EXPENSE - Advertising costs are expensed as incurred. Advertising expense was \$779,398 for the nine months ended December 31, 2003.

SHIPPING AND HANDLING EXPENSE - Shipping and handling costs are included in the cost of sales.

WARRANTY EXPENSE - The Companies offer a warranty for one year on the Second Look units which coincides with the warranty offered by the manufacturer. Since substantially all warranty claims submitted to the Company are covered by the manufacturers warranty, no additional warranty reserve has been recorded as of December 31, 2003.

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### QUALIA COMPUTING, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----

##### NOTE C - ACCOUNTS RECEIVABLE

Trade	\$ 2,382,904
Employees	686
Miscellaneous	31,666
Related party (Note J)	63,833
	-----
	\$ 2,479,089
	=====

##### NOTE D - INVENTORY

Finished goods	\$ 1,640,031
Inventory on consignment	971,768
Inventory reserve	(1,154,163)
	-----
	\$ 1,457,636
	-----

##### NOTE E - PROPERTY AND EQUIPMENT

Leasehold improvements	\$ 9,729
Furniture, fixtures, and equipment	201,074
Computer equipment	195,579
Research equipment	1,065,506
Manufacturing equipment	219,590
Software	103,119

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Total cost	1,792,597
Less accumulated depreciation and amortization	942,356
	-----
	\$ 8501241
	=====

NOTE F - OTHER ASSETS

Deposits	\$ 245,414
Premium advance receivable - life insurance	100,000
Patent cost	342,143
Accumulated amortization - patents	(52,965)
	-----
	\$ 634,592
	=====

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QUALIA COMPUTING, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE G - ACCRUED EXPENSES

Wages, bonuses, and commissions	\$ 747,291
Vacation	91,841
Payroll taxes	9,436
401 K	63,543
Personal property, sales, and other miscellaneous taxes	28,067
Unearned revenue	216,500
	-----
	\$ 1,156,678
	=====

NOTE H - OPERATING LEASES

The Company leases its facilities for \$32,960 per month. The lease expires in December 2010. The Company is also responsible for utilities, real estate taxes, common area maintenance, cleaning and security. The lease amount increases annually throughout the life of the lease. The lease may be renewed for two additional terms of five years each. In connection with this lease, the Company is paying an additional \$1,727 per month for additional build out costs incurred by the lessor for the Company.

The Company is leasing a copier for \$654 per month. The lease expires in February 2008.

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The Company assumed operating leases for computers leased from Shire Biochem. At the end of the lease, the computers are to be returned to Shire. The lease payment is set in Canadian dollars and varies each month as the number of computers leased varies monthly, The final lease payment is due in February 2005.

The Company also leases additional equipment and storage space as needed during the period. The lease expense for the nine months ended December 31, 2003 was \$382.161. Future minimum lease payments are as follows:

2004	\$	426,494
2005		428,211
2006		440,039
2007		453,005
2008		459,171
Thereafter		958,712
		-----
	\$	3,165,632
		=====

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### QUALIA COMPUTING, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

##### NOTE I - CUSTOMER LEASES

The Company has entered into leasing arrangements with customers for the lease, with an option to purchase the Second Look units. The lease agreements require the lessees to pay to the Company a percentage of the revenue generated by the units. At the end of the lease, the lessees have the option to purchase the unit for an agreed-upon sales price, less the amount already paid to the company.

##### NOTE J - RELATED PARTY TRANSACTIONS

The Company engaged non-employee stockholders in consulting agreements to perform work on behalf of the Company. The total consulting fees paid under these agreements was \$137,502 for the nine months ended December 31, 2003.

The Company has accounts receivable due from a related party in the amount of \$165,390 at December 31, 2003. An allowance for doubtful accounts of \$101,557 has been recorded against this as of December 31, 2003.

The Company has a note receivable due from a related party in the amount of \$1,000,000 at December 31, 2003. The note is due in full on December 31, 2007. Interest is being charged at the prime rate as identified by the bank (4.00% as of December 31, 2003) and is due annually on August 21, the anniversary date of the note. The note is being reserved for the full amount due to substantial doubt about the ability of the borrower to repay the debt.

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### NOTE K - 401 (K) PLAN

The Company sponsors a contributory defined contribution pension plan as defined by IRS Code Section 401 (k). All employees who have attained 21 years of age are eligible to participate in the plan. The Company will match 50% of the first 6% of each employee's wages deferred. An employee is vested in these matching and discretionary funds on a schedule of 20% each year until fully vested after completing five years of service with the Company. At the discretion of the board of directors, the Company may make discretionary contributions to the plan. Total matching and discretionary contributions made by the Company for the nine months ended December 31, 2003 amounted to \$91,673.

### NOTE L - INCOME TAXES

The Company records a provision for federal income taxes on items included in the statement of operations regardless of the period when such taxes are payable. Deferred income taxes result from timing differences in the recognition of income and expense for tax and financial statement purposes.

The Company has loss carryforwards totaling \$30,316,963 that may be offset against future taxable income, which expire beginning in 2013 through 2023. The Company has research tax credits totaling \$1,650,988 which expire beginning in 2013 through 2023. The Company also has a capital loss carryforward totaling \$3,644 that may be offset against future capital gains. If not used, the capital loss carryforward will expire in 2004. The deferred tax asset increased to \$13,552,233 at December 31, 2003 because of additional net operating loss carryforwards and research credits.

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## QUALIA COMPUTING, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

### NOTE L - INCOME TAXES - continued

Management now believes it is more likely than not that the deferred tax asset will not be realized due to ownership changes which will limit a portion of the loss carryforwards available (See Note A). Accordingly, in 2003, a valuation allowance of \$13,552,233 was recorded against the deferred tax asset. No amounts were charged to the provision for federal income taxes for the nine months ended December 31, 2003.

### NOTE M - STOCKHOLDERS' EQUITY

As of December 31, 2003, prior to the acquisition and merger into Qualia Acquisition Corp. (See Note A), the following shares of stock were authorized, issued and outstanding:

	AUTHORIZED -----	ISSUED -----
Common shares (Class A, \$.00001 par value)	1,905,554	907,500
Common shares (Class B, \$.00001 par value)	952,777	780,000

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Class A and B shares have voting rights and are entitled to receive dividends on a pro rata basis. Class B shares shall upon a triggering event, be converted without cost into class A shares. Also, upon a triggering event, all stock options exercisable into Class B shares shall be converted automatically into the right to exercise Class A shares. A triggering event shall include a merger, consolidation, reorganization, recapitalization, or any sale, lease, assignment or transfer of all or substantially all assets of the Company. The merger as describe in Note A is a triggering event.

NOTE N - STOCK OPTIONS

The Company initiated a stock option plan approved by the stockholders in February 2001. All options issued to date vest in equal installments over a period of four years with the first installment beginning twelve months following the date of grant. The compensation committee, as delegated by the board, determines the vesting schedule of the options. Prior to September 2002, the term of each option could not exceed ten years from the date of the grant of the option. During September 2002, the plan was amended to have no expiration date. The option plan does not allow the issuance of options in an aggregate amount that would result in the outstanding options being greater than 10% of the total number of Class A and B shares outstanding at the time of the option grant. As a condition of the merger as described in Note A, the stock option plan was terminated on December 31, 2003.

Stock option activity is presented as follows:

	OPTIONED SHAMS (CLASS A)	OPTION PRICE PER SHARE
	-----	-----
Balance, March 31, 2003	125,300	1.00
Options issued	52,200	1.00
Options exercised	(177,500)	1.00
	-----	-----
Balance, December 31, 2003	-	
	-----	

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QUALIA COMPUTING, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE N - STOCK OPTIONS - CONTINUED

OPTIONED SHARES	OPTION PRICE
--------------------	-----------------

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	(CLASS B)	PER SHARE	TOTAL
	-----	-----	-----
Balance, March 31, 2003	-	1.00	-
Options issued	50,000	1.00	50,000
options exercised	(50.00)	1.00	(50,000)
	-----		-----
Balance, December 31, 2003	-		-
	=====		=====

NOTE O - DISTRIBUTION AGREEMENTS

The Company signed an agreement with General Electric Company (GE) in June 2003 to distribute digital and analog digital products. The agreement expires December 31, 2007 with options to renew for one year terms. The Company signed a three year agreement with Source One in September 2003 to distribute analog products. The agreement states that there are minimum targets for each of the three years. If the minimums are not met, the Company has the right to convert the agreement to a nonexclusive agreement or terminate the agreement. With the completion of these two agreements, it is the Company's intent to use distributors as the primary sales vehicle, however, the Company has retained the right to execute direct sales activities as necessary to achieve revenue targets.

NOTE P - ACCELERATED PAYMENT AGREEMENT

The Company has entered into an accelerated payment program with General Electric Capital Corporation (GE Capital). The agreement provides payment to the Company upon shipment of goods to GE as provided in the purchase orders. There is a discount associated with the payment of the invoices to the Company. The discount percentage decreases daily from the date of the shipment until the invoice is paid by GE Capital. The agreement expires in October 2004.

NOTE Q - FOREIGN CURRENCY ITEMS

Cadx Canada, Cadx France and Cadx Ireland transacted a portion of their business using foreign currency. The transactions have been recorded in accordance with FASB 52 using the current rate of exchange, as applicable, on the transaction date. Gains or losses from the settlement of the foreign currency transactions are reported in other income (expense), as applicable on the payment date.

Foreign currency losses amounting to \$56,667 have been reported in the other income (expense) for the nine months ended December 31, 2003.

Cadx Canada, Cadx France, and Cadx Ireland use foreign currency as their functional currency. Translation adjustments result from the process of translating those entities' financial statements into the reporting currency of Qualia Computing, Inc. In accordance with FASB 52, those translation adjustments are not included in determining net income but are reported separately and accumulated in a separate component of equity called cumulative translation adjustments.

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QUALIA COMPUTING, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE R - SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid during the nine months for:

Interest paid	\$	53,579
		=====

Noncash investing and financing activities:

Net book value of assets abandoned	\$	164,325
		=====

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INDEPENDENT AUDITORS' REPORT ON CONSOLIDATED  
SUPPLEMENTARY INFORMATION

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/s/ BRADY WARE & SCHOENFELD, INC.

Dayton, Ohio  
February 3, 2004

## QUALIA COMPUTING, INC. AND SUBSIDIARIES

## CONSOLIDATED SCHEDULE OF SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

-----  
NINE MONTHS ENDED DECEMBER 31, 2003

Wages	\$ 4,691,594
Bonuses	429,516
Payroll taxes	236,371
Employee benefits	426,653
401(k) match and profit sharing	91,673
Bank charges	11,796
Computer supplies	32,853
Repair and maintenance	28,341
Consulting fees	350,225
Legal and professional fees	1,192,851
Meals and entertainment	178,915
Contributions	11,399
Travel	831,844
Training and seminars	4,691
Office expense	59,141
Postage and freight	215,849
Rent and lease expense	382,161
Market research	73,160
Dues and subscriptions	23,601
Advertising	779,398
Depreciation expense	294,492
Amortization expense	15,229
Insurance	131,504
Miscellaneous taxes	73,864
Telephone and utilities	174,839
Personal property taxes	16,660
Licenses	32,302
Tuition assistance	4,898
Bad Debt	332,957
Relocation expense	30,346
Expenses allocated to cost of sales	(344,951)
	-----
	\$ 10,813,972
	-----

See independent auditors' report on consolidated supplementary information. 15



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### UNAUDITED PRO FORMA COMBINED CONDENSED FINANCIAL STATEMENTS

The following unaudited pro forma combined condensed financial statements give effect to the merger of iCAD, Inc. ("iCAD") and Qualia Computing, Inc. ("Qualia") using the purchase method of accounting, as required by Statement of Financial Accounting Standard No. 141, "Business Combinations." Under this method of accounting, iCAD allocated the purchase price to the fair value of assets acquired, including identified intangible assets and goodwill based on estimates it believes to be reasonable. The purchase price allocation is subject to revision when iCAD obtains additional information regarding asset valuation. The unaudited pro forma combined condensed balance sheet assumes the merger took place on September 30, 2003 and reflects the net proceeds of approximately \$5,900,000 from iCAD's November 2003 private placement of 1,260,000 shares of its common stock and additional investment rights which gave the investors in the offering the right to purchase, for a limited period, up to 315,000 additional shares of common stock at \$5.00 per share. The unaudited pro forma combined condensed statements of operations assume that the merger took place as of January 1, 2002. The unaudited pro forma information is presented for illustration purposes only in accordance with the assumptions set forth below. This information is not necessarily indicative of the operating results or of the financial position that would have occurred if the merger had been consummated on the dates indicated nor is it necessarily indicative of future operating results or financial position of the combined enterprise. The unaudited pro forma combined condensed financial information does not reflect any adjustments to reflect any cost savings or other synergies anticipated as a result of the merger.

	UNAUDITED PRO FORMA COMBINED CONDENSED BALANCE SHEET AS OF SEPTEMBER 30, 2003		
	iCAD (1)	Qualia (2)	Proforma Adjustments
	-----	-----	-----
<b>Current assets:</b>			
Cash and equivalents	\$ 587,879	\$ 446,031	\$ (1,550,000)
			5,900,000
Trade accounts receivable, net of allowance for doubtful accounts	1,027,266	2,479,089	(225,883)
Inventory	531,402	1,457,636	
Prepaid and other	177,713	63,523	
	-----	-----	-----
Total current assets	2,324,260	4,446,279	4,124,117
	-----	-----	-----
<b>Property and equipment:</b>			
Equipment	953,722	1,581,794	
Leasehold improvements	21,250	9,729	
Furniture and fixtures	35,569	201,074	
	-----	-----	-----
	1,010,541	1,792,597	-
	-----	-----	-----
Less accumulated depreciation and amortization	666,583	942,356	-
	-----	-----	-----

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Net property and equipment	343,958	850,241	-
	-----	-----	-----
Other assets:			
Identifiable intangible assets	3,387,125	289,178	3,404,822
Goodwill	17,415,723	-	25,789,497
Other assets	-	345,414	
Patents, net	94,643		
	-----	-----	-----
Total other assets	20,897,491	634,592	29,194,319
	-----	-----	-----
Total assets	\$ 23,565,709	\$ 5,931,112	\$ 33,318,436
	=====	=====	=====

PF1

Current liabilities:			
Accounts payable	\$ 1,765,368	\$ 2,722,133	(225,883)
Accrued interest	262,834		
Accrued expenses	1,309,821	1,156,678	686,620
Loans payable to sellers	-		
Note Payable	-		
Convertible subordinated debentures	10,000	-	
Current maturities of note payable	69,048	-	1,125,000
	-----	-----	-----
Total current liabilities	3,417,071	3,878,811	1,585,737
Convertible promissory notes payable	2,930,000	-	
Note payable, less current maturities	56,155	-	3,375,000
	-----	-----	-----
Total liabilities	6,403,226	3,878,811	4,960,737
	-----	-----	-----
Stockholders' equity:			
Convertible preferred stock	86	-	
Common stock	273,978	17	(17)
			43,000
			12,600
Additional paid-in-capital	88,130,846	36,488,492	(36,488,492)
			24,467,000
			5,887,400
Accumulated deficit	(70,292,163)	(34,531,251)	34,531,251
Cumulative translation adjustment		95,043	(95,043)
Treasury stock, at cost	(950,264)		
	-----	-----	-----
Stockholders' equity	17,162,483	2,052,301	28,357,699
	-----	-----	-----
Total liabilities and stockholders' equity	\$23,565,709	\$ 5,931,112	\$ 33,318,436
	=====	=====	=====

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- (1) The iCAD balance sheet is as of September 30, 2003.  
 (2) The Qualia balance sheet is as of December 31, 2003.

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UNAUDITED PRO FORMA COMBINED CONDENSED STATEMENT OF OPERATIONS  
 FOR THE YEAR ENDED DECEMBER 31, 2002

	ICAD (1)	Qualia (2)	Proforma Adjustments
	-----	-----	-----
Sales	\$ 6,246,432	\$ 9,889,027	\$ (23,309)
Government grant revenue	-	101,847	
Total revenues	6,246,432	9,990,874	(23,309)
Cost of sales	5,585,384	4,604,632	(11,188)
Gross margin	661,048	5,386,242	(12,121)
Operating expenses:			
Engineering and product development	1,950,171	5,186,105	
General and administrative	7,715,085	3,454,961	616,000
Marketing and sales	987,587	9,535,139	
Total operating expenses	10,652,843	18,176,205	616,000
Loss from operations	(9,991,795)	(12,789,963)	(628,121)
Interest and other income (expense), net	(48,167)	215,772	(246,094)
Net loss before taxes	(10,039,962)	(12,574,191)	(874,215)
Income tax provision (expense)	-	(8,766,361)	8,766,361
Net loss	(10,039,962)	(21,340,552)	7,892,146
Preferred dividends	148,050	-	

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Net income (loss) available to common shareholders	\$ (10,188,012)	\$ (21,340,552)	\$ 7,892,146
Net loss per share basic and diluted	\$ (0.39)		
Weighted average number of shares used in computing earnings per share	26,000,177		4,300,000

- (1) The iCAD financial statements for the year ended December 31, 2002 include the results of iCAD for the twelve months ended December 31, 2002 as adjusted to include twelve months results of ISSI which was acquired on June, 2002 (See Note 3).
- (2) The Qualia financial statements for the year ended December 31, 2002 include the results of Qualia for the 12 months ended March 31, 2003, the Company's fiscal year-end as adjusted to include the twelve-months results of CADx which was acquired on September 26, 2002. (See Note 4).

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UNAUDITED PRO FORMA COMBINED CONDENSED STATEMENT OF OPERATIONS  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003

	iCAD	Qualia	Pro Forma Adjustments
Sales	\$ 4,938,629	\$ 10,325,256	\$ (237,789)
Total revenues	4,938,629	10,325,256	(237,789)
Cost of sales	2,233,775	4,990,485	(114,139)
Gross margin	2,704,854	5,334,771	(123,650)
Operating expenses:			
Engineering and product development	1,813,560	2,727,329	
General and administrative	6,370,414	2,682,668	462,000
Marketing and sales	1,077,189	5,403,975	
Total operating expenses	9,261,163	10,813,972	462,000

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Loss from operations	(6,556,309)	(5,479,201)	(585,650)
	-----	-----	-----
Interest and other (income) expense, net	47,644	234,724	184,571
	-----	-----	-----
Net loss	(6,603,953)	(5,713,925)	(770,221)
Preferred dividends	110,733	-	-
	-----	-----	-----
Net loss available to common shareholders	\$ (6,714,686)	\$ (5,713,925)	\$ (770,221)
	=====	=====	=====
Net loss per share basic and diluted	\$ (0.25)		
Weighted average number of shares used in computing earnings per share	26,531,177		4,300,000

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NOTES TO UNAUDITED PRO FORMA COMBINED CONDENSED FINANCIAL STATEMENTS

1. BASIS OF PRO FORMA PRESENTATION

The unaudited pro forma combined condensed financial statements of iCAD have been prepared on the basis of assumptions relating to the allocation of consideration paid to the acquired assets and liabilities of Qualia based on management's best preliminary estimates. The actual allocation of the amount of the consideration may differ from that reflected in these unaudited pro forma combined condensed financial statements after a third party valuation and other procedures have been completed.

Below are tables of the estimated acquisition costs and estimated purchase price allocation for Qualia:

Fair value of iCAD common stock issued	\$24,510,000
Cash consideration and promissory note	6,050,000
Direct acquisition costs	686,620
	-----
Total purchase price	\$31,246,620
	=====
Net tangible assets acquired	\$ 1,763,123
Estimated fair value of identifiable intangible assets	3,694,000
Goodwill	25,789,497
	-----
Total Acquisition Cost	\$31,246,620
	=====

2. PRO FORMA ADJUSTMENTS

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(a) Reflects the components of the purchase consideration and related transaction costs which consist of iCAD common stock with a market value of \$24,510,000, \$1,550,000 cash and a \$4,500,000 promissory note and direct acquisition costs of \$686,620. The value of iCAD common stock was based upon a per share value of \$5.70, equal to the closing price on November 28, 2003, the day the acquisition was announced. Also reflects the net proceeds of approximately \$5,900,000 for iCAD's November 2003 private placement of 1,260,000 shares of its common stock and additional investment rights to purchase up to 315,000 additional shares of common stock.

(b) Represents adjustments to increase the carrying values of identifiable intangible assets and record goodwill acquired.

(c) Reflects the elimination of amounts owed between iCAD and Qualia.

(d) Reflects the elimination of existing stockholders' equity of Qualia.

(e) Reflects the elimination of sales between iCAD and Qualia.

(f) Represents amortization of increase in value of acquired identifiable intangible assets of Qualia based upon average estimated useful lives of six years ( $3,694,000/6 \text{ years} = \$616,000 \text{ per year}$ )

(g) Reflects the increase in weighted average basic and diluted shares outstanding for the common stock issued in connection with the merger. Pro forma basic and diluted loss per share was calculated assuming that the 4,300,000 shares of iCAD common stock issued in connection with the merger were issued at the beginning of the period presented.

(h) Reflects the interest associated with the note payable of \$4,500,000 issued in connection with the Acquisition at an assumed expected average interest of 6.25%. Year ended December 31, 2002 - Average Borrowings of \$3,937,500 x 6.25% = \$246,094.

(i) Elimination of Qualia tax provision due to loss of combined entities.

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### 3. ADJUSTMENTS TO ICAD FINANCIAL STATEMENTS

#### PRO FORMA FINANCIAL STATEMENT ICAD FOR THE YEAR ENDED DECEMBER 31, 2002

	iCAD	ISSI	Proforma Adjustments
	-----	-----	-----
Sales	\$ 5,000,184	\$ 1,602,452	\$ (356,204)
Total revenues	5,000,184	1,602,452	(356,204)
Cost of sales	5,161,643	603,156	(179,415)
	-----	-----	-----

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Gross margin	(161,459)	999,296	(176,789)
Operating expenses:			
Engineering and product development	1,626,001	324,170	
General and administrative	6,595,076	938,509	181,500
Marketing and sales	987,587	-	
Total operating expenses	9,208,664	1,262,679	181,500
Loss from operations	(9,370,123)	(263,383)	(358,289)
Interest and other income (expense),net	(48,167)	-	
Net income (loss) before tax	(9,418,290)	(263,383)	(358,289)
Income tax provision (expense)	-	-	
Net loss	(9,418,290)	(263,383)	(358,289)
Preferred dividends	148,050	-	
Net income (loss) available to common shareholders	\$ (9,566,340)	\$ (263,383)	\$ (358,289)
Net loss per share basic and diluted	\$ (0.46)		
Weighted average number of shares used in computing earnings per share	20,928,397		5,071,780

Pro Forma Adjustments

(3a) Reflects the elimination of sales between iCAD and ISSI.

(3b) Reflects the amortization of intangible asset.

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4. ADJUSTMENTS TO QUALIA FINANCIAL STATEMENTS

PRO FORMA FINANCIAL STATEMENT QUALIA  
FOR THE YEAR ENDED DECEMBER 31, 2002

	Qualia	CADx	Proforma Adjustments
	-----	-----	-----
Sales	4,990,493	\$ 5,196,534	\$ (298,000)
Government grant revenue	101,847	-	

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Total revenues	5,092,340	5,196,534	(298,000)
Cost of sales	2,216,179	2,388,453	
Gross margin	2,876,161	2,808,081	(298,000)
Operating expenses:			
Engineering and product development	2,478,993	2,707,112	
General and administrative	2,438,235	1,016,726	
Marketing and sales	4,911,917	4,921,222	(298,000)
Total operating expenses	9,829,145	8,645,060	(298,000)
Loss from operations	(6,952,984)	(5,836,979)	-
Interest and other income (expense), net	215,772	-	
Net loss before tax	(6,737,212)	(5,836,979)	-
Income tax provision (expense)	(8,759,473)	(6,888)	
Net loss	(15,496,685)	(5,843,867)	-
Preferred dividends	-	-	
Net income (loss) available to common shareholders	(15,496,685)	\$ (5,843,867)	\$ -
Net loss per share basic and diluted	\$ (10.61)		
Weighted average number of shares used in computing earnings per share	1,460,000		

PRO FORMA ADJUSTMENTS

(4a) Reflects the elimination of Royalty between Qualia and CADx.

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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 hereunto duly authorized.

iCAD, INC.

By /s/ W. Scott Parr

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W. Scott Parr, President &  
Chief Executive Officer



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Dated: March 15, 2004