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Zacks Small-Cap Research

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Verisante Technology Inc. (V.VRS)

V.VRS: Aura Data Published. Operations On-Track.

OUTLOOK

Comprehensive analysis of the 1,000-lesion study were accepted for publication by *Cancer Research*, a peer-reviewed journal of the American Association of Cancer Research and the most widely cited cancer journal in the world.

Verisante and Aura continue to be recognized as a top emerging technology.

Operations appear to be tracking expectations. Commercial roll-out of Aura expected in 2H 2012. Distributor in place for Canada. Agreements for Europe and Australia expected next.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	02/04/2011
Current Price (04/05/12)	$0.61
Six- Month Target Price	**$2.60**

SUMMARY DATA

52-Week High	**$1.26**
52-Week Low	**$0.50**
One-Year Return (%)	**N/A**
Beta	**N/A**
Average Daily Volume (sh)	**166,950**
Shares Outstanding (mil)	**60**
Market Capitalization ($mil)	**37**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**N/A**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2011 Estimate	**N/A**
P/E using 2012 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**N/A**
Type of Stock	**N/A**
Industry	**Med/Dental-Supp**

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2010	5 A	6 A	0 A	0 E	11 A
2011	0 A	0 A	0 E	0 E	0 E
2012					5,385 E
2013					21,185 E

Earnings per Share

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2010	-$0.01 A	-$0.01 A	-$0.01 A	-$0.01 A	-$0.04 A
2011	-$0.02 A	-$0.01 A	-$0.02 A	-$0.01 E	-$0.06 E
2012					-$0.07 E
2013					$0.04 E

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

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Aura Study Results Published

Comprehensive analysis of the 1,000-lesion study were accepted for publication by *Cancer Research*, a peer-reviewd journal of the American Association of Cancer Research and the most widely cited cancer journal in the world. The manuscript, titled "Real-time Raman Spectroscopy for In Vivo Skin Cancer Diagnosis", was first published in the online version of the journal in late March.

As a reminder, Verisante announced the preliminary statistical analysis earlier this year which were presented by Dr. Haishan Zeng at the SPIE (international society for optics and photonics) conference in San Francisco. Data was acquired on over 1,000 lesions from 848 patients. The study analysis focused on only those classes of lesions that are considered to be associated with concern of skin cancer - which resulted in a final dataset of 518 lesions from 453 patients. Specifically, the classes of skin lesions included in the analysis were those diagnosed as malignant or premalignant (i.e. - malignant melanoma, squamous cell carcinoma, basal cell carcinoma, and actinic keratosis - in aggregate, these represent essentially 100% of skin cancers) and benign conditions that look like skin cancer (i.e. - seborrheic keratosis, atypical nevi, malanocytic nevi, compound nevi, and intradermal and blue nevi).

The study focused on three distinct categories, specifically Aura's ability to differentiate; 1) skin cancers and pre-cancers from benign skin lesions, 2) melanomas from non-melanoma pigmented lesions, and 3) melanomas from seborrheic keratoses. Statistical analysis was done using two methods; principal component with general discriminant analysis (GDA) and partial least squares. With sensitivities between 95% and 99%, Aura demonstrated specificities in these three tasks between 15% and 54% with GDA (in most instances using partial least squares resulted in higher specificities) - which resulted in a biopsy ratio (the number of non-melanoma lesions that undergo biopsy for each confirmed case of melanoma) of between 0.77:1 to 5.56:1. Specifically (see Table 3 from the study below) the GDA analysis showed, in differentiating 1) skin cancers and pre-cancers from benign skin lesions, specificity was 17% at 99% sensitivity and 41% at 95% sensitivity (partial least squares showed specificity of 24% at 99% and 52% at 95%) 2) melanomas from non-melanoma pigmented lesions was 15% at 99% sensitivity and 38% at 95% sensitivity, and 3) melanomas from seborrheic keratoses was 25% at 99% sensitivity and 54% at 95% sensitivity. The study authors concluded that, " Raman spectroscopy can distinguish (1) malignant and premalignant lesions from benign disorders, (2) melanomas from benign pigmented skin lesions, and (3) melanomas from seborrheic keratoses."

The biopsy ratio is a metric which helps gauge the accuracy of melanoma diagnosis - the lower the ratio, the more accurate the diagnosis. Misdiagnosis of skin cancer is rampant, often resulting in unnecessary biopsies. Biopsies can be costly, uncomfortable, and result in scarring. If Aura can improve the accuracy of diagnosis (which we believe it can), there should be substantial commercial demand for the device. Relative to the biopsy ratio, for reference the manuscript cites a retrospective study of ~5,000 pigmented skin lesions evaluated by ~500 general practitioners which resulted in a biopsy ratio between 58:1 and 21:1 (i.e. - 21 non-melanoma lesions biopsied for every confirmed case of melanoma). Other unrelated studies have indicated biopsy ratios in clinical practice may be even significantly higher than these figures. Although it's not necessarily fair (as there could be significant differences in the make-up of the various studies) to make a direct comparison of the biopsy ratios in the Aura study (which appear comparably very strong) with these other studies, at least on the face of it, the Aura data looks potentially persuasive.

As we noted in our most recent update, the Aura data does look to be very compelling relative to clinical trial data from MELA Sciences Melafind device which showed a sensitivity of 98% and specificity of about 10% in the detection of melanoma. Aura's biopsy ratio appears similarly relatively strong. Also noteworthy is that MELA opted to use a statistical method different than either GDA or partial least squares, both of which are considered conservative. As such, it's possible that Aura's specificities may have been relatively even stronger than Melafind's had the statistical methods used for both devices' studies been the same. Also as we've previously explained, Aura has other advantages to Melafind including a significant speed advantage (allowing for full body scans) and the ability to detect of all types of skin cancer whereas Melafind is used for only melanoma.

Table 3. Summary of Raman spectroscopy diagnostic parameters derived from ROCs according to various levels of sensitivity.

Diagnosis classification task	Sensitivity level (95% CI)	Principal component analysis (GDA[a])				Partial least squares			
		Specificity (95% CI)	PPV [b]	NPV [c]	Biopsy ratio	Specificity (95% CI)	PPV	NPV	Biopsy ratio
Skin cancers + Actinic keratosis *vs* Benign lesions	0.99 (0.98-1.00)	0.17 (0.13-0.21)	0.49	0.95	1.03:1	0.24 (0.19-0.29)	0.51	0.97	0.95:1
	0.95 (0.92-0.99)	0.41 (0.35-0.48)	0.57	0.91	0.77:1	0.52 (0.48-0.58)	0.62	0.93	0.62:1
	0.90 (0.86-0.94)	0.64 (0.58-0.70)	0.67	0.89	0.49:1	0.66 (0.61-0.71)	0.68	0.89	0.47:1
Melanoma *vs* Benign pigmented lesions	0.99 (0.96-1.00)	0.15 (0.11-0.19)	0.15	0.99	5.58:1	0.14 (0.10-0.18)	0.15	0.99	5.65:1
	0.95 (0.89-1.00)	0.38 (0.32-0.44)	0.19	0.98	4.24:1	0.44 (0.38-0.50)	0.21	0.98	3.83:1
	0.90 (0.81-0.99)	0.68 (0.63-0.73)	0.30	0.98	2.31:1	0.63 (0.57-0.69)	0.27	0.98	2.67:1
Melanoma *vs* Seborrheic keratosis	0.99 (0.96-1.00)	0.25 (0.17-0.33)	0.34	0.98	1.96:1	0.46 (0.37-0.55)	0.41	0.99	1.41:1
	0.95 (0.89-1.00)	0.54 (0.45-0.63)	0.44	0.97	1.25:1	0.52 (0.43-0.61)	0.43	0.96	1.31:1
	0.90 (0.81-0.99)	0.68 (0.59-0.77)	0.52	0.95	0.92:1	0.66 (0.57-0.75)	0.51	0.94	0.98:1

[a] GDA: general discriminant analysis.

[b] PPV: positive predictive value, the ratio of true positives to the total of true positives and false positives.

[c] NPV: negative predictive value, the ratio of true negative to the total of true negatives and false negatives.

Operational Update

- **Distribution:** Verisante penned an agreement with Clarion Medical Technologies for exclusive distribution of Aura in Canada. Specific terms of the deal were not announced. We anticipate agreements for distribution in Australia and parts of Europe to be next.

- **Commercial Production 2H 2012:** Verisante noted in an early April press release that they expect 10 beta Aura systems to be completed and ready for field testing this month with manufacturing and production expected to commence in the second half of the year. These timelines are largely in-line with management's prior expectations and correspond with our general forecast.

- **Lung Cancer Study:** Clinical study at the Lung Tumor Center at Vancouver General Hospital for Verisante's lung cancer application device, Core, is expected to wrap up later this year. Data analysis will follow and is expected to be submitted for publication. As Core is essentially a derivative of Aura and ISO certification is already in place, Verisante expects regulatory approval of Core in Europe, Canada and Australia (i.e. - where Aura is already approved for sale) to be seamless.

- **FDA Meeting:** Management noted in late December that they expected to have an initial meeting with the FDA during Q1 2012 to discuss the potential U.S. regulatory approval pathway for Aura. We hope to hear an update in the near future. As we noted in the past, our expectations (although we have no particular insight on this) are that FDA approval will need to come via the PMA process and be supported with data from additional clinical testing - this pre-IDE meeting will hopefully provide guidance on the regulatory pathway as well as what the

FDA will be looking for in regards to supporting data/information. Our current (as well as initial) assumptions are that Aura could be on the U.S. market by 2014.

- **Mexico and Brazil:** Verisante has begun the registration process to sell Aura in Mexico and Brazil. The company hopes to obtain registration in Mexico in 2012 and Brazil possibly in late 2013.

More Awards

Verisante continues to impress the technology, medical and investment communities. Among the latest recognition was being named the TSX Venture Exchange's top Technology and Life Sciences Company. The TSX Venture Exchange's annual list of its top 50 emerging publicly traded companies is a ranking of the strongest performers from five industry sectors. Verisante ranked number one on the list of top 10 leading Technology and Life Sciences companies for the year. Companies are selected based on four equally weighted criteria - return on investment, trading activity, market capitalization growth, and analyst coverage. The results were obtained from data to December 31, 2011. In honor of the award, Verisante's CEO, Thomas Braun, was invited to the exchange to participate in the opening of the market on April 3rd.

Verisante got some icing on the cake with also being awarded the "Pick of the Street" in the Technology and Life Sciences Sector of the TSX Venture Exchange. "Pick of the Street" is chosen by a poll of fund managers, analysts, bankers, and retail brokers.

The recent recognition follows Aura being given a "Best of What's New" award by *Popular Science* magazine in November, naming it as a top technology of 2011. Editor in Chief of the publication, Mark Jannot, noted that "The Best of What's New Award is the magazine's top honor and the 100 winners, chosen from among thousands of entrants, represent the highest level of achievement in their fields." Also in late 2011, the Canadian Cancer Society cited a clinical study using Verisante's laser Raman Spectroscopy in the detection of lung cancer as one of its "Top 10 Canadian Cancer Society Funded Research Stories of 2011".

FINANCIAL STATEMENTS

INCOME STATEMENT (CDN $)

Verisante Technology

	2010 A	Q1A	Q2A	Q3A	Q4E	2011 E	2012 E	2013 E	2014 E
Device sales	$0	$0	$0	$0	$0	$0	$1,890	$14,175	$36,855
% total sales	-	-	-	-	-	-	*90.8%*	*82.6%*	*77.6%*
Cap sales	$0	$0	$0	$0	$0	$0	$192	$2,976	$10,632
% total sales	-	-	-	-	-	-	*9.2%*	*17.4%*	*22.4%*
Revenue	$11	$0	$0	$0	$0	$0	$2,082	$17,151	$47,487
YOY Growth	*-62.5%*	*-100.0%*	*-100.0%*	*#DIV/0!*	*#DIV/0!*	-	-	*723.8%*	*176.9%*
Device COGS	$0	$0	$0	$0	$0	$0	$945	$7,088	$18,428
Cap COGS	$0	$0	$0	$0	$0	$0	$10	$149	$532
Cost of sales	$8	$0	$0	$0	$0	$0	$955	$7,236	$18,959
Gross Income	$3	$0	$0	$0	$0	$0	$1,127	$9,915	$28,528
Gross Margin	*26.0%*	-	-	-	-	-	*54.1%*	*57.8%*	*60.1%*
SG&A	$1,435	$639	$753	$982	$850	$3,224	$3,222	$3,718	$4,012
% SG&A	-	-	-	-	-	-	*154.8%*	*21.7%*	*8.4%*
R&D	$215	$7	$0	$0	$0	$7	$2,720	$1,055	$1,010
% R&D	-	-	*4.9%*	*4.7%*	*5.1%*	-	*130.6%*	*6.2%*	*2.1%*
Interest expense (income), net	$0.4	$0.0	($13.5)	($14.8)	$0.0	($28.3)	$0.0	$0.0	$0.0
Operating Income	($1,648)	($646)	($739)	($968)	($850)	($3,231)	($4,815)	$5,142	$23,506
Operating Margin	-	*#DIV/0!*	*#DIV/0!*	*#DIV/0!*	*#DIV/0!*	-	-	*30.0%*	*49.5%*
Total Other Income	$163	($93)	($20)	($20)	($25)	($158)	($25)	($979)	($2,799)
Pre-Tax Income	($1,485)	($739)	($759)	($988)	($875)	($3,389)	($4,840)	$4,163	$20,707
Taxes (benefit)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$1,040.7	$5,590.8
Tax Rate	*0.0%*	*0.0%*	*40.0%*	*40.0%*	*40.0%*	*0.0%*	*0.0%*	*25.0%*	*27.0%*
Net Income	($1,485)	($739)	($759)	($988)	($875)	($3,389)	($4,840)	$3,122	$15,116
Net Margin	-	*#DIV/0!*	*#DIV/0!*	*#DIV/0!*	*#DIV/0!*	-	-	*18.2%*	*31.8%*
EPS	($0.04)	($0.02)	($0.01)	($0.02)	($0.01)	($0.06)	($0.07)	$0.04	$0.19
YOY Growth	*30.4%*	*78.8%*	-	-	-	*44.6%*	*10.4%*	*-161.1%*	*354.3%*
Diluted Shares O/S	35,159	43,109	56,897	59,508	63,200	55,678	72,000	76,000	81,000

Source: Zacks Investment Research *Brian Marckx, CFA*

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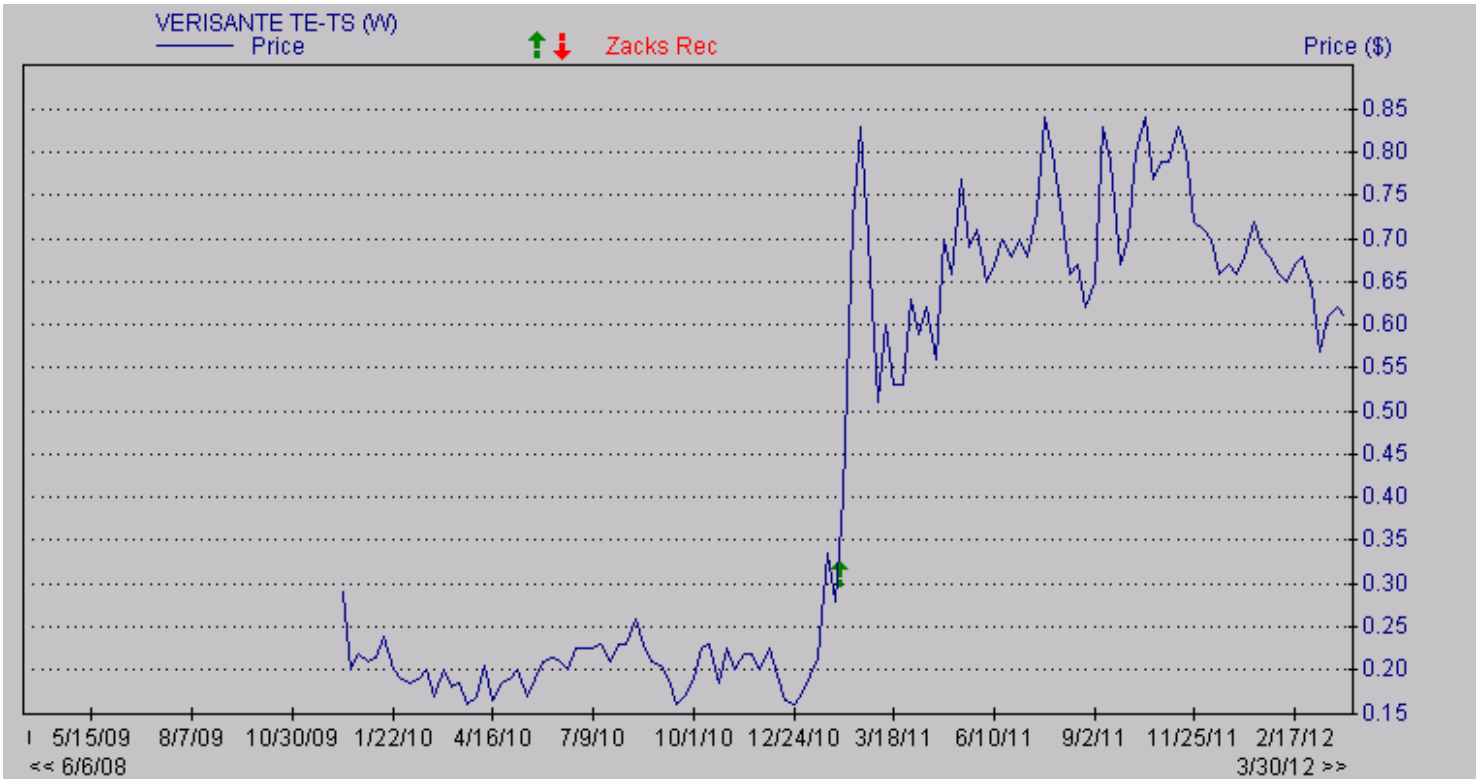
HISTORICAL ZACKS RECOMMENDATIONS



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