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Zacks Small-Cap Research

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Verisante Technology Inc. (V.VRS)

V.VRS: Initial Aura Sales Booked In Q1

OUTLOOK

Aura officially launched in Canada and Europe. Initial sales commenced in Q1. We expect more substantial revenue towards the back half of the year as the roll-out will likely be measured and drawn out. The initial marketing strategy largely consists of placing the units with key opinion leaders and to increase awareness of the device, the technology and the benefit to patients and healthcare practices.

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. This should provide additional support for marketing purposes as well as potentially to help support the U.S. regulatory program.

Aura continues to be recognized as one of the leading novel medical technologies throughout the world and has racked up several high-profile awards and accolades over the last 2 years.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	02/04/2011
Current Price (05/31/13)	$0.38
Target Price	**$2.25**

SUMMARY DATA

52-Week High	**$0.65**
52-Week Low	**$0.28**
One-Year Return (%)	**N/A**
Beta	**N/A**
Average Daily Volume (sh)	**38,204**
Shares Outstanding (mil)	**69**
Market Capitalization ($mil)	**26**
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 2013 Estimate	**N/A**
P/E using 2014 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)
2012	0 A	0 A	0 A	0 A	0 A
2013	246 A				1,985 E
2014					6,195 E
2015					20,705 E

Earnings per Share

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2012	-$0.01 A	-$0.01 A	-$0.01 A	-$0.02 A	-$0.05 E
2013					-$0.04 E
2014					-$0.03 E
2015					$0.03 E

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

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Q1 Highlighted By Initial Aura Sales

Q1 Financials

Verisante filed their financials for the first quarter ending March 31, 2013 on May 30th. The company booked their first Aura-related sales in the quarter with $235k in revenue related to shipments of the device to their distributors. The number of units sold was not disclosed in the filing although Verisante had previously announced that they had sold nine units. Gross margin, at 13%, is slim although we expect to see this expand with commercialization progress, benefitting from manufacturing volume, reduction of material input costs, sales of the higher margin caps and some firming up in pricing. Operating expenses were $1.15 million, very much in-line with our $1.05 million estimate. Net loss and EPS were $1.18 million and ($0.02), compared to our $1.03 million and ($0.02) estimates.

Cash burn (including $637k in capitalized R&D) was $1.7 million. VRS exited Q1 with $1.2 million in cash and equivalents. Subsequent to the close of the quarter, VRS raised $943k (gross) from the sale of common stock w/ warrants.

We continue to model additional sales throughout the current year. We think there may be some quarterly variability over the next several periods due to stocking orders and potentially only limited pull-through demand in the near-term. Our mid and longer-term outlook also remains intact, including a steeper placement curve materializing in early 2014. We view the recent progress with establishing greater distribution as a meaningfully positive operational development and recent string of various award wins and recognitions as important votes of confidence in the technology and product from the medical and scientific communities.

We expect VRS's near-term goals include additional regulatory approvals (i.e. - Brazil, Mexico in the near-term), further broadening distribution, optimizing Aura input costs (including making engineering and material refinements and optimizing manufacturing and sourcing), and defining and moving down the FDA regulatory pathway.

We are maintaining our $2.25/share price target and Outperform rating.

Meaningful Progress On Several Fronts

Verisante continues to make meaningful progress on several fronts including commercialization of Aura, continued product development, regulatory matters, financing, and product and market awareness initiatives. Below is a quick snapshot of some of these activities over the last few months.

> Capital Raise

In mid-May Verisante raised $943k (gross) from the sale of 2.38 million shares of common stock (@ $0.40/share) with 100% warrant coverage. The warrants have a two-year term and are exercisable at $0.60/share. Verisante has the right to call in the expiration dates of the warrants to within ~30 days of the following events; 50% of warrants if Verisante's volume weighted trading price reaches $0.90 or greater for 10 consecutive days, the other 50% of warrants if Verisante's volume weighted trading price reaches $1.15 or greater for 10 consecutive days.

Verisante exited 2012 with $1.7 million in cash and equivalents and has been burning (including capitalized R&D) roughly $1.3 million per quarter. While this cash raise will provide some operating capital, we expect the company will look to raise additional funds to help catalyze the ongoing roll-out of Aura.

> Distribution Further Beefed Up

On the heels of the ex-U.S. launch of Aura Verisante has significantly expanded their distribution. Over the last few months Verisante has penned agreements with several distributors covering large swaths of Europe including Germany, Switzerland, and Austria. Laserwelt has a substantial footprint throughout Germany, Austria and Lichtenstein and is a top distributor of medical devices. Germany, in particular, is expected to be an important territory for Verisante's Aura as it is the only country with a national skin cancer screening program and one of the largest markets for medical devices in general.

The other recently announced distribution agreements are with Pacifica Handels AG covering Switzerland and an expanded agreement with BO-Pharma which now also covers the Nordic countries of Norway, Denmark, Finland and Iceland in addition to the initial agreement which was for the Benelux region (Belgium, Netherlands, Luxembourg). And as a reminder, Verisante had previously announced a distribution agreement with Clarion Medical Technologies for the Canadian market.

VRS is focused on continuing to expand their distribution footprint and will look to continue to add distributors in other territories.

> Aura Launched
In late January Verisante announced that they received their first orders for Aura from their distributors in Canada and Europe. Manufacturing was up and running and shipping began shortly afterwards.

In March Verisante, in concert with Laserwelt, announced the official launch of Aura in Germany. The announcement was made at the Annual Dermatology Congress "Dermatological Practice", one of the major dermatology conferences in Europe. The Germany launch was followed in mid-April by VRS's announcement that they were holding an official Canadian launch in Vancouver. There are currently at least nine commercial systems placed throughout Canada and Europe. VRS currently expects to have approximately 100 units produced within roughly the next 9 to 12 months and anticipates " being able to record material revenues in 2013."

The initial roll-out and marketing strategy largely consists of placing the units with key opinion leaders and to increase awareness of the device, the technology and the benefit to patients and healthcare practices. Presentations, word-of-mouth, testimonials and recommendations from physicians and key opinion leaders that have already used Aura can be highly influential for promoting the benefits of the device. This, however, will take some time which means the unit placement curve will likely be somewhat drawn out.

> Aura Continues To Rack Up Awards
Verisante's trophy case continues to fill up with the latest award coming in early February when Aura won the 2013 Prism Award in the Life Sciences and Biophotonics category. The award was presented to VRSEF management during the annual SPIE Photonics West conference which attracts over 1,500 companies and 20,000 attendees and which is billed as the world's largest and most influential photonics and optics event. The award recognized Aura as the best new photonics product on the market and beat out entries from throughout the world including a microscope objective from imaging giant Olympus and an ultrafast laser from Femtolasers, both of which were finalists for the award.

Just days after the SPIE event Aura was named a 2013 finalist for an Edison Award under the Science/Medical, Diagnostic/Analytical Systems category. Per the Edison Awards website describing the awards,
"The Edison Awards™ are among the most prestigious accolades honoring excellence in new product and service development, marketing, human-centered design and innovation. Unique to the world of award programs, the Edison Awards™ are focused on the innovators as much as the innovations. Award winners represent "game changing" products, services and excellence and leadership in innovation around four criteria: Concept, Value, Delivery and Impact. An Edison Award represents significant value to the award winner and to the cause of innovation."

Verisante and Aura again were in good company as a finalist. The other three finalists in their category were; 3M Molecular Detection System by 3M, AccuVein AV400 by AccuVein Inc, and 3-D Motion Capture System by Dynamic Athletic Research Institute. The award winners were announced in late April with Verisante taking home the bronze.

As a reminder Verisante and their cancer detection products and technology have already racked up a number of high profile accolades over the recent past including Popular Science's Best of What's New Award for 2011, being named as a top cancer breakthrough of 2011 by the Canadian Cancer Society and the company being named as the top ranking technology and life sciences company on the TSX Venture 50.

> Core for Lung Cancer
Study data using Verisante's exclusively licensed technology which is expected to be incorporated into a lung cancer detection device called Core, affirmed positive results from an earlier pilot study. The studies used VRS's Raman spectral analysis combined with autofluorescence to detect cancer. The recent data comes from a larger sample size (267 samples) compared to the smaller (129 samples) pilot study and also used the latest generation Raman system technology. The result was an improvement in the already impressive 91% specificity seen in the pilot study with only a slight reduction in sensitivity (which was 96% in the pilot study) in the ability to differentiate localized high grade dysplasia and carcinoma from benign lesions. The new study results were presented by BC Cancer Agency researchers in a poster entitled Characterization of Pre-Neoplastic and Neoplastic Bronchial Lesions Using Laser Raman Spectroscopy at the BC Cancer Agency Annual Conference (Nov 29 - Dec 1) and were also presented at SPIE Photonics West 2013 (Feb 2 - 7, 2013) where VRS was honored with the above-mentioned award.

As a reminder, results of the small (129 samples from 26 patients) pilot study which used Verisante's Raman system technology, combined with white light and fluorescence bronchoscopy (technology which Verisante acquired in June 2011) for the early detection of lung cancer were published in the July 2012 issue of the *Journal of Thoracic Oncology*. Results showed that when Verisante's Core lung cancer detection device (using Raman technology) is combined with the ClearVu and ClearVu Elite endoscopy system (which Verisante acquired) the number of false positives were reduced by over 75% compared to traditional endoscopic methods.

As we've noted in the past that while the results of these studies are encouraging, as is Verisante's continued efforts to move their lung cancer detection program forward, we feel it is still too early to reasonably judge the potential for approvability of the device. In addition, management's current major focus is with getting Aura commercialized. As a result, we feel it is appropriate to continue to not incorporate a contribution from Core in our model until there is more information to comfortably judge the probability of regulatory approval and gauge launch timelines. If and when that happens, we will update our model accordingly also as we noted in the past, this could potentially add significant upside to our current revenue and earnings estimates (especially given the relatively large size of the lung cancer diagnostics market).

Valuation

We model more substantial sales towards the back half of the current year as we expect the initial roll-out to be somewhat slow and measured. Pre-IDE submission package related to the U.S. regulatory program and pathway is in process of being finalized. We now model an assumed U.S. launch in late 2015 to early 2016.

We use 10-yr DCF to value VRS. Key inputs to our 10-year DCF model include a 10% discount rate and 2% terminal growth rate. Our DCF model values VRS at about $2.25/share.

FINANCIAL STATEMENTS

INCOME STATEMENT (CDN $)

Verisante Technology

	2011 A	2012 A	2013 E	2014 E	2015 E	2016 E
Device sales	$0	$0	$1,810	$5,009	$16,380	$31,456
% total sales	-	-	*91.2%*	*80.8%*	*79.1%*	*76.4%*
Cap sales	$0	$0	$175	$1,187	$4,325	$9,743
% total sales	-	-	*8.8%*	*19.2%*	*20.9%*	*23.6%*
Revenue	$2	$0	$1,985	$6,195	$20,705	$41,199
YOY Growth	-	-	-	*212.2%*	*234.2%*	*99.0%*
Cost of sales	$0	$0	$1,429	$3,321	$8,643	$16,215
Gross Income	$2	$0	$555	$2,874	$12,062	$24,984
Gross Margin	-	-	*28.0%*	*46.4%*	*58.3%*	*60.6%*
SG&A	$3,435	$3,201	$4,479	$6,050	$9,105	$14,070
% SG&A	-	-	*225.7%*	*97.7%*	*44.0%*	*34.2%*
R&D	$7	$52	$156	$225	$275	$325
% R&D	-	-	*7.9%*	*3.6%*	*1.3%*	*0.8%*
Interest expense (income), net	($41.0)	($33.6)	($20.3)	($20.0)	($20.0)	($35.0)
Operating Income	($3,399)	($3,219)	($4,059)	($3,381)	$2,702	$10,624
Operating Margin	-	-	*-204.5%*	*-54.6%*	*13.0%*	*25.8%*
Total Other Income	($153)	($291)	($161)	($372)	($1,242)	($2,472)
Pre-Tax Income	($3,551)	($3,510)	($4,220)	($3,752)	$1,460	$8,152
Taxes (benefit)	$0.0	$0.0	$0.0	$0.0	$0.0	$1,222.8
Tax Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*15.0%*
Net Income	($3,551)	($3,510)	($4,220)	($3,752)	$1,460	$6,929
Net Margin	-	-	*-212.6%*	*-60.6%*	*7.0%*	*16.8%*
EPS	($0.06)	($0.05)	($0.06)	($0.05)	$0.02	$0.08
YOY Growth	*54.3%*	*-17.0%*	*4.4%*	*-19.7%*	*-137.1%*	*358.9%*
Diluted Shares O/S	54,651	65,112	74,962	83,000	87,000	90,000

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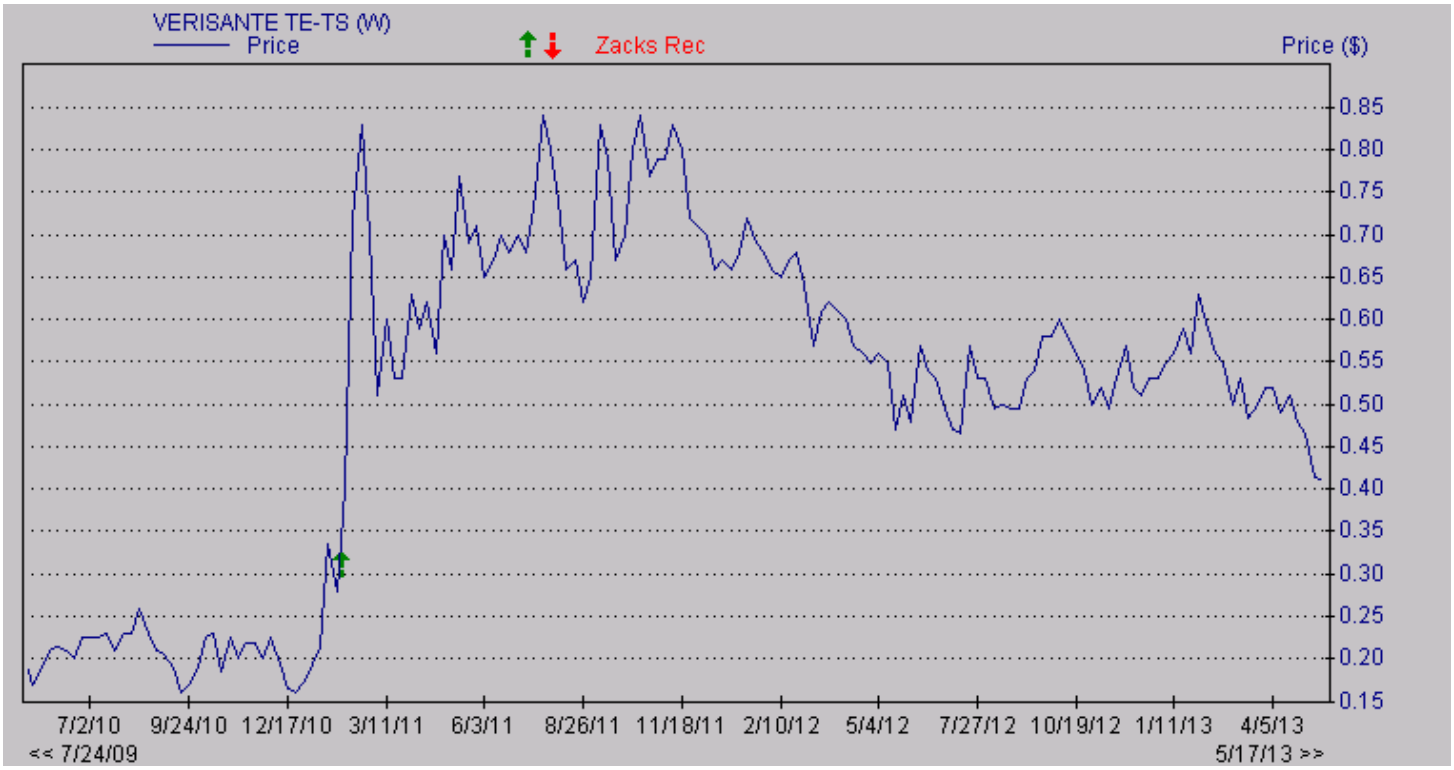

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