

Summary

The focus at Optiscan since the last investor update has been on:

- continuing market development activities for the company's compact, hand-held scanner, the Stratum;
- ensuring early progress with Pentax and the flexible endoscope project; and
- preparing for clinical trials using the rigid endoscope as a precursor to commercialisation.

Stratum

There has been positive and constructive feedback from the company's key USA users following installation early this year of the Stratum at several sites. The instruments are now in regular use at Memorial Sloan Kettering Cancer Center (MSK) in New York, the Medical College of Wisconsin (MCW) and University of California, Davis (UCD).

The formation of a Scientific Advisory Board (comprising senior scientific and academic staff from trial sites) has created an excellent forum to pool knowledge and user experience. It has also provided early user feedback on functionality, identifying minor modifications and improvements which will be incorporated in subsequent model upgrades.

Optiscan executives have recently attended a series of conventions including:

- DDW (Digestive Diseases Week), USA
- SID (Society for Investigative Dermatology), USA
- World Congress of Dermatology, Paris

Many expressions of interest were received, especially from technical staff and researchers, confirming the company's view that the initial market for Stratum will be at the clinical research end of the dermatology market.

Optiscan's strategy is to target early adopters, then the high end of the market, after which we are confident the technology will be taken up by the general dermatology market. The feedback and reaction we are receiving from both USA sites and the exhibition circuit confirm that this is the right strategy. The clinical research market has sufficient potential to satisfy early sales targets while the wider market in mainstream dermatology develops and matures. This strategy also enables Optiscan to engage potential distribution partners as we proceed.

Optiscan continues limited production of Stratum at its Melbourne plant, including a number of units for both the USA and European markets. One of these has recently been sold to Linkoping University Hospital in Sweden. This is a leading centre of dermatology research in Europe, and provides an important presence in the European market.

Optiscan's attendance at the World Congress of Dermatologists in Paris in early July has also increased our profile substantially. This was a very successful exhibition for Optiscan with a higher than expected level of interest and inquiry, currently being followed up by our USA office and our distributor in Germany.

Flexible Endoscope & Pentax

The first few months of Optiscan's new relationship with Pentax has shown good progress.

Following completion of the agreement in February 2002, The Optiscan and Pentax engineering teams have been working together on the specifications of the first Pentax flexible endoscope to incorporate Optiscan's confocal microscope.

The engineers from both companies met at Optiscan's Melbourne facility in April, and developed and signed off the first stage specification within two days. Those involved were pleased with the progress achieved in the initial integration of the products. There is more still to be done, but the willing and co-operative spirit that characterised the early negotiations continues.

At the Digestive Diseases Week Conference in USA, Optiscan exhibited the first prototype Pentax endoscope to be fitted with our confocal microscope. Again, this generated strong interest and drew large numbers of visitors to our booth. It also provided an opportunity for Optiscan to interact with the Pentax USA marketing team and introduce them to the new product. The Optiscan booth was staffed with researchers and representatives from our USA Stratum sites, enabling visitors to speak to users of the technology. Optiscan's marketing team is currently pursuing leads and expressions of interest.

The first product release from the flexible endoscope project with Pentax is expected to be achieved in the second half of 2003.

Investors will be aware that Optiscan received an initial payment from Pentax of \$6.5 million in February this year. The company received a second tranche payment of \$6.5 million in April following a placement of 3.33 million shares at \$US1.00 per share, representing around A\$1.92 per share. This agreement has provided the company with a strong cash position, with \$16 million on hand at June 2002.

Progress with Rigid Endoscopes

Optiscan's engineering research team has been developing a number of rigid endoscopes to demonstrate the potential of the technology in this active market. This benefit follows our achievements in miniaturisation, which enabled the flexible endoscope and the agreement with Pentax.

The market for rigid endoscopes is different to the flexible market, which is occupied by only a handful of participants, one of which is Pentax. The rigid endoscope market is far more diverse, and tends to be segmented according to application. For example, Storz of Germany has a strong presence in gynaecology, while Circon Corporation from USA has a greater interest in urology. This structure creates a multiplicity of market opportunities, and serves to highlight the difference with the Stratum, where there is no existing product or supplier to establish a first point of market entry.

Optiscan has developed clinical grade prototypes for evaluation in cervical applications. Commencement of the clinical trials has been delayed by the finalisation of liability insurance arrangements. These are expected to be resolved soon, and the trials should commence shortly thereafter. This will then enable the company to identify the potential interest of existing participants in the various market segments.

The rigid endoscope product group is the third application of the company's platform technology. It has considerable potential, with an established market and a number of significant international companies well represented. However, Optiscan must balance its activities of developing rigid endoscope applications with the demands of meeting our obligations to Pentax as well as continuing to nurture the uptake of the Stratum in the international marketplace.

Optiscan is currently preparing its Annual Report, which will provide a further update on progress when it is released in September.

Yours sincerely

Peter Delaney
Managing Director
