

OPTISCAN LIMITED (OIL)

\$0.23

RECOMMENDATION: **SPECULATIVE BUY**



DEVELOPER OF MEDICAL OPTICAL DEVICES

NO. SHARES:	100.1m
AVG. MONTHLY T/O:	1.9m
MKT CAP:	\$23m
LAST REVIEW:	23/1/08 (SCG3)
ROLLING YEAR HIGH:	\$0.60
LOW:	\$0.18
MOAT RATING:	None
BUSINESS RISK:	High
SHARE PRICE RISK:	High



Optiscan is a world leader in microscopy technology. A deal with Pentax is likely to lead to the roll-out of a miniaturised version of the core technology incorporated into flexible endoscopes, the primary instrument used by gastroenterologists. The core technology has been incorporated in other applications including a rigid endoscope, licensed to Carl Zeiss, like Pentax, a world leader in optical technology. While the technology is convincingly validated, delays in commercialisation may lead to further capital raising. Until meaningful evidence of sales traction the stock remains speculative.

Sales momentum still marginal

The market has all but forgotten OIL. Its deal with Pentax for the Japanese company to sell endomicroscopes – scanners with miniaturised microscopes - to gastroenterologists has so far yielded little. Last year Pentax and fellow Japanese company Hoya agreed to merge. OIL management believes the subsequent integration process has taken priority over new projects. It is logical that OIL's product will become a priority for Pentax/Hoya given unquestionable potential to seize market share in a significant market. We estimate the annual total market for endomicroscopes to be in the order of \$1bn.

OIL is exploring opportunities in other niche areas of application where it intends to commercialise products itself. Products for these new applications may be ready for launch as early as 2009. These areas are likely to offer higher margins, and because they do not require fundamental change

of doctor behaviour, should be easier to penetrate than the gastroenterology market. In the latter the technology allows doctors to make diagnoses via visual inspection, compared with the usual process which requires lab analysis of a biopsy, a far more expensive, time-consuming process.

Awareness of the endomicroscope is beginning to build more rapidly as opinion leaders raise its profile. For example nearly 150 gastroenterologists recently met in Milan to learn about the instrument. This included watching nine live surgical cases, each dealing with a different disease condition, beamed to the conference. A prominent German surgeon who is a strong proponent of the technology organised the conference.

OIL has around \$4.5m or one year of funding remaining. This means a capital raising is likely at depressed prices unless some sort of partnering deal brings in additional cash. One risk that makes stocks such as OIL speculative is the inability to quantify the funding that will be required and at what price, the combination determining the degree of dilution of existing holders. The need for dilutive funding potentially makes Pentax's lack of performance all the more costly. We are reasonably confident the giant Japanese company will focus some of its considerable marketing resources on OIL's product, but we don't know when. Pentax has around 20% market share in the endoscope market that is dominated by Olympus with 60%. OIL's scope has the potential to reverse these positions given its clear superiority. The deal with Pentax is unfortunately exclusive, which magnifies the impact of Pentax's apparent lack of urgency.

By the end of the year the trials in Europe and the US are likely to firmly establish the product's credibility among the broader global gastroenterology profession. This logically should result in a noticeable increase in demand but possibly with a lag of up to a year for doctors' budgets to incorporate an allocation for the instrument.

Recommending a stock of a company generating little revenue and a still uncertain path to earnings in a bearish market feels somewhat futile, given the lack of interest from a fearful and shell-shocked market. We know that sentiment will eventually change and a select few higher risk stocks will provide outstanding returns from extremely oversold levels. In the meantime the weak share price exacerbates funding risk. We lower our recommendation trigger levels around 15% to reflect the growing likelihood of a dilutive capital raising and the continuing lack of marketing energy from Pentax. Investors will need both patience and nerve, particularly while the overall sharemarket sentiment remains bearish.

WHO'S BUYING AND WHO'S SELLING?

Director and Substantial Shareholder Transactions

COMPANY	DIRECTORS	DATE OF CHANGE	BOUGHT (+) SOLD (-)	NO. SHARES TRADED	RELEVANT INTEREST	AVG PRICE
Equinox Minerals	Craig Williams	24-Apr-08	-	4,132,191	1,449,410	n/a
SUBSTANTIAL SHAREHOLDERS					(%)	
Mortgage Choice	FMR Corporation	24-Apr-08	-	1,379,144	12.3	