

### Skinvisible, Inc. (OTC BB: SKVI) – Initiating Coverage - A unique and attractive drug delivery system with a broad range of industry applications

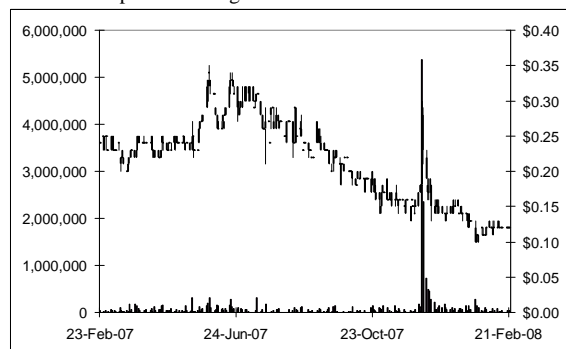
Sector/Industry: Healthcare/Biotech/Pharma

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

#### Market Data (as of February 22, 2008)

Current Price	US\$0.12
Fair Value	US\$1.00
Rating*	BUY
Risk*	4 (Speculative)
52 Week Range	US\$0.10 – US\$0.35
Shares O/S	65,081,248
Market Cap	US\$7.81 mm
Current Yield	N/A
P/E (forward)	N/A
P/B	N/A
YoY Return	-50.0%
YoY OTCBB	N/A

\*see back of report for rating and risk definitions



#### Investment Highlights

- Skinvisible develops polymer delivery vehicles for topical skincare products. Their patented topical polymer delivery vehicle, Invisicare®, has the capability to bind active compounds to the skin for an extended time frame, thereby allowing enhanced delivery performance for skincare agents resulting in improved efficacy.
- Although there are several other drug delivery systems in the market today, Invisicare®'s advantages, primarily the 'minimum four-hour staying power', make it a very unique and attractive delivery system.
- The company has a very interesting revenue model; approximately 50% of the company's revenues have zero operating costs.
- Skinvisible currently has four products that are licensed, and 29 different products that are waiting to be licensed. Their goal for the next three years is to license a minimum of 10 products that each generate over \$10 million in annual revenues for the licensee.
- We believe the company's patented technology, and an attractive revenue model, make it a good acquisition target for major pharmaceutical companies.

#### Risks

- Ongoing success depends on achieving innovative polymer delivery results, licensing agreement negotiations, royalty revenues, various patents pending, as well as their legalities, and conformance to any regulatory and environmental requirements.
- Market recognition and brand awareness are key factors that will impact long-term growth prospects.

Key Financial Data (FYE - December 31) (US\$)	2005	2006	2007E	2008E
Revenue	850,280	691,452	796,102	1,803,194
Net Income	(1,031,151)	(2,098,276)	(1,267,679)	(579,991)
EPS	(0.02)	(0.03)	(0.02)	(0.01)
Cash	30,729	50,070	17,411	44,110
Working Capital	(941,096)	(1,043,664)	(1,107,023)	(582,326)
Total Assets	1,271,495	887,191	687,013	654,388
Total Debt	-	25,728	253,222	253,222

*Skinvisible, Inc. is a research and development company that has formulated and patented innovative polymer delivery technology and compositions for topical skin applications. Its primary objective and focus is to license its patented polymer delivery technology (Invisicare®) and sell its trademarked polymer delivery vehicles and formulated products to established dermatological, medical, cosmetic, cosmeceutical and skincare brand manufacturers.*

## Company Overview

Skinvisible Inc. “SKVI”, through its wholly owned subsidiary Skinvisible Pharmaceutical Inc., develops polymer delivery vehicles for topical skincare products (applied directly to the skin). Their patented polymer delivery technology, called Invisicare®, helps bind active ingredients of topical skincare products (cream, ointment, lotion, gel and sprays) to the skin. Invisicare®’s forte is its ability to hold active/inactive ingredients on the skin for an extended timeframe (for up to four hours or more) and resist wash-off without interfering with the normal functions of the skin, like breathing and perspiration. These qualities lead to a significant increase in the efficacy of active ingredients. Another major benefit of Invisicare® is that it does not use alcohol, waxes, silicones or other organic solvents. The disadvantages of delivery systems that use organic solvents are that they can cause irritation, and can potentially damage the skin in the long-term. Although there are several other drug delivery systems in the market today, we believe Invisicare®’s advantages, primarily the ‘minimum four-hour staying power’, make it a very unique and attractive delivery system.

Invisicare® has broad industry applications. It can be used to enhance performance of established prescription drugs as well as over-the counter (OTC) dermatological, medical, cosmetic and skincare products. According to Kline and Company, the market for specialty actives and active delivery systems for personal care in the U.S. and Western Europe was worth \$400 million in 2006. Below are pictures of some of Skinvisible’s products incorporating Invisicare®.



Source: Skinvisible, Inc.

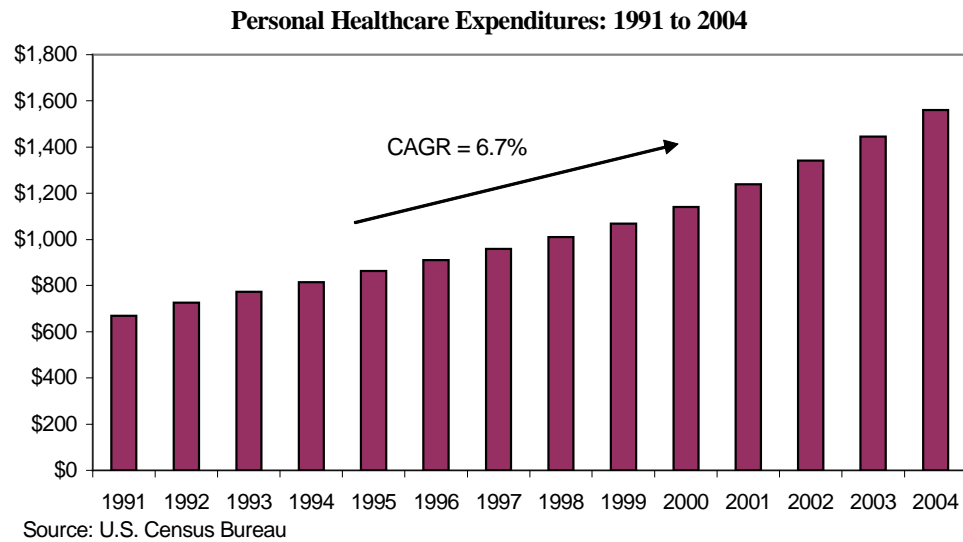
Instead of marketing and distributing their products themselves, SKVI generates revenues by licensing products formulated with Invisicare® (proprietary products or products developed in collaboration with other companies) to pharmaceutical companies. By licensing their products, the company receives an upfront licensing fee and royalty payments. This revenue model, which is a model that companies developing delivery platforms typically adopt, has high gross margins, as licensing and royalty fees, which are expected to account for approximately 50% of the company’s total revenues, have no operating costs. The company also generates revenues by selling their polymers to licensees, and by private labeling end products developed in-house.

Skinvisible currently has four products that are licensed, and 29 different products that are waiting to be licensed. The company’s goal for the next three years is to license a minimum of 10 products that each produce over \$10 million in annual revenues for the licensee.

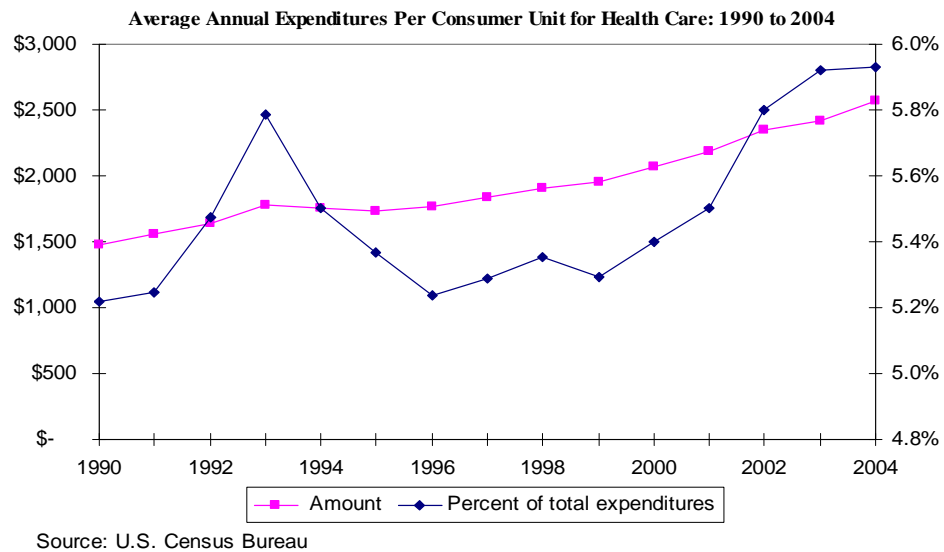
**Market Potential**

Skinvisible’s technology targets the global skincare sector. In the next section, we will take a look at the growth prospects in this industry.

According to the U.S. Census Bureau, personal healthcare expenditures in the U.S. have risen at a compounded annual growth rate (CAGR) of 6.7% during 1991 – 2004 (as shown in the chart below), from \$670 billion to \$1.56 trillion, and are estimated to grow at a rate of 7.2% per annum during 2005 – 15.



The chart below shows the average annual expenditures per consumer for healthcare in the U.S.



The average annual expenditures, by an American, on healthcare grew by a CAGR of 4% during 1990 – 2004, from \$1,480 to \$2,574. During the same time period, healthcare expenditures as a percentage of total expenditures grew from 5.2% to 5.9%. Although we do not expect a major change in this ratio, we expect healthcare expenditures to continue to grow along with total expenditures moving forward.

Healthcare is one of the most important sectors of any economy in the world. Both charts above show that, unlike other fast growing and volatile industries, the healthcare industry has not had a boom/bust cycle, and is an industry that has grown consistently and steadily YOY in the long-term.

We now take a look at the global skincare industry. The global skincare market is estimated to be worth \$43.06 billion in 2007 (according to Chemical Market Reporter). Asia Pacific accounts for 39%, Europe accounts for 33%, and North and South America account for 27% of the global market. The table below shows the growth in the global skincare market during 2003 – 07.

<u>Global Skincare Market (US\$millions)</u>			
<b>Geographic Regions</b>	<b>2003</b>	<b>2005</b>	<b>2007</b>
Asia Pacific	14,142.5	15,475.0	16,790.8
Europe	11,296.8	13,163.6	14,305.9
North/South America	10,184.4	10,797.5	11,488.2
Other	379.5	421.9	470.1
Source: Chemical Market Reporter			

Europe had the fastest growth rate of 6.1% per annum during 2003 – 07, while Asia Pacific, and North and South American markets grew at 4.4% and 3.1%, respectively.

According to the American Academy of Dermatology, over 80% of Americans will be affected by some kind of skin condition in their lifetime. The U.S. dermatology market alone is estimated to be worth about \$10 billion. The U.S. market has experienced growth of 10% per annum, much higher than the long-term growth of the U.S. healthcare industry of 6.7%.

Skincare products including anti-ageing, acne and sun care products, accounted for nearly 60% of the market in 2007. The most recent available information on the market sizes and growth rate forecasts of the three largest segments are presented below.

- **Anti-aging products** are expected to continue to experience the highest growth rate of 11.3% through 2010, the driving force of which will be the baby boomer generation.
- According to Kalorama Information, the global market for **prescription acne and rosacea**, which had a CAGR of only 2.5% during 1998 – 2006, is expected to grow from \$1.95

billion in 2006, to \$2.23 billion by 2008 (CAGR of 7%).

- The global **sun-care market** was worth \$6.2 billion in 2006. According to MarketResearch.com, the global market is expected to grow to \$7.2 billion (CAGR of 7.8% in 2006 – 08) in 2008.

In addition to the above-mentioned segments, other segments in the skincare industry, including moisturizers, cleansers, and hand and body lotions, are also expected to experience healthy growth rates going forward (according to MarketResearch.com).

**To summarize, the above forecasts show that the skin care market is expected to grow at a faster pace than the entire healthcare sector, which itself is expected to grow at a healthy and steady rate.** We now analyze how Skinvisible intends to capitalize on the growing global skincare sector.

### *History*

Skinvisible was incorporated in Nevada in March 1998, under the name Microbial Solutions Inc. The company changed its name to its current form in February 1999. Skinvisible acquired Skinvisible Pharmaceuticals Inc. (formerly known as Manloe Laboratories Inc.) in March 1998, and obtained the exclusive right and license to manufacture, distribute, market and sell all products developed by the inventor, which included two antibacterial skin protector products incorporating the proprietary polymer delivery vehicle, Invisicare®.

Subsequently, the company modified the original products (by changing the active ingredient from Benzalkonium Chloride to Triclosan) and developed a new and improved hand sanitizer formulation. Instead of marketing and selling their own products, the company decided to license its patented technology and proprietary products to pharmaceutical companies worldwide. As mentioned earlier, this model is very attractive, as it allows the company to achieve high gross margins (as licensing and royalties have no operating costs).

Skinvisible's office, consisting of approximately 7,000 square feet of leased office, laboratory, and warehouse space, is located in Las Vegas, Nevada. The company currently has three licensed products, and has developed several other topical dermatology products that are available for licensing to the pharmaceutical and skincare industries. The company utilizes FDA registered independent laboratories to carry out independent verifications of their formulations and to conduct investigative product studies, utilizing protocols incorporating Good Lab Practice and Good Clinical Practice ("GLP/GCP") standards. Skinvisible currently has 6 employees, and all of the research and development is performed in-house. The company's insiders own approximately 45% of the outstanding shares.

### *The Invisicare® Technology*

Invisicare®'s strength is its ability to combine hydrophilic (water soluble) and hydrophobic (water insoluble) polymers into stable complexes in water emulsions. This capability of Invisicare® is the key in holding active ingredients of topical products on the skin for extended periods of time. The technology is formulated primarily to carry water insoluble active ingredients in water-based products without the use of solvents like alcohol, silicones or waxes. The primary problem with using alcohol is that prolonged usage can disturb the constitution of the cell membrane, as membrane lipids are soluble in solvents, and eventually

lead to skin damage.

The Invisicare® polymer family offers five distinctive formulations that hold active ingredients on the skin (M, C, D, P and S series). Formulations are chosen based on the subject active ingredient.

Skincare products incorporating Invisicare® have the following benefits over those that do not contain Invisicare®.

- **Independent studies have proven that Invisicare® holds active ingredients on the skin for up to four hours or more** –By binding active ingredients to the skin for an extended period of time, Invisicare® improves the efficacy of topical drugs. Also, Invisicare® gradually releases active ingredients thereby reducing skin irritation.
- **Does not contain organic solvents such as alcohol, silicones or waxes**– Unlike other delivery platforms, Invisicare® does not interfere with the normal functioning of the pores or the exfoliation of skin cells. Products incorporating Invisicare® gradually wear off as part of the natural exfoliation process.
- **Resistance to wash-off** – Users do not have to re-apply after washing their hands, face or other area where the product has been applied, which leads to cost savings as lower dosage of the active agent is required.
- **Non-occlusive** – This allows normal skin respiration and perspiration, and provides protection against exposure from a wide variety of environmental irritants.
- Invisicare® has broad industry applications, as it is **highly compatible with a variety of active ingredients**.

***Competition -  
Other delivery  
systems***

Although there are several companies in the market today that develop drug delivery systems, Invisicare®'s advantages, we believe, make it a very unique and attractive delivery system for any topical skincare product.

In the next section, we present some of the competing delivery systems as summarized the chart on the next page.

Company	Delivery System	Patented	Comments	Market Cap	Revenues & EPS
Stiefel Laboratories (and Connetics Corporation)	VersaFoam® - emulsion foam delivery vehicle	U.S.	ethanol-free delivery vehicle; end products are moisturizing, non-stinging, non-sticky and absorbs quickly into the skin	private company	not known
Foamix Ltd	Five delivery platforms; primary platforms are Foamix Foam and OILGEL™	U.S., Australia, N.Z. and S.Africa	a drug development company, based in Israel, specializing in dermatologic and other topical products; their foam delivery platforms (used in products like Rogaine®) are alcohol free, suitable for a variety of oil-soluble, water-soluble and suspended drugs	private company	not known
A.P.Pharma (NASDAQ: APPA)	Biochronomer™ polymer-based drug delivery technology - Microsponge®	19 U.S.patents and 108 foreign patents	recently sold royalty rights to two skin treatments (made with its Microsponge® delivery system) for up to \$30 million	\$48.02 mm	no revenues in FY2006 as they sold their royalties; FY2005 - \$5.39 mm
NexMed (NASDAQ: NEXM)	NexACT® - drug delivery technology	13 U.S. patents	transdermal platform; their drugs address a variety of health conditions, such as nail fungus, sexual disorders and more.	\$115.90 mm	FY2006 - \$1.87 mm
SkyePharma PLC (NASDAQ: SKYE)	Broad range of drug delivery technologies (IDD®Technology); for topical products they use hyaluronic acid gel technology	Yes	has 11 approved products in the areas of oral, inhalation and topical delivery	\$225.5 mm	\$88.15 mm
Noven Pharmaceuticals (NASDAQ: NOVN)	Develops transdermal drug delivery technologies and prescription transdermal products	30 U.S. and over 180 foreign patents (as of 2004)	their products include Vivel-Dot® (estradiol transdermal system), the most prescribed estrogen patch in the U.S., and Daytrana™ (methylphenidate transdermal system), the first and only patch approved for the treatment of ADHD.	\$398.97 mm	\$60.69 mm

The most important result of our analysis is that, unlike Invisicare®, none of the above-mentioned delivery systems claim to hold active ingredients on the skin for a minimum of four hours. Market capitalizations of comparable companies that we have presented range between \$48.02 million and \$398.97 million versus only \$9.7 million for SKVI.

One recent development in the industry that deserves mention is the acquisition of Connetics Corporation, a company with a patented foam delivery technology (VersaFoam-EF technology), by Stiefel Laboratories Inc. (private company), the world's largest independent pharmaceutical company specializing in dermatology, for \$640 million. This acquisition, we believe, reflects the importance of delivery platforms for pharmaceutical companies worldwide.

In addition to competition from other delivery platforms, Skinvisible also faces indirect competition from pharmaceutical and cosmeceutical companies that have products in the categories that Skinvisible has developed products. However, based on all its qualities, we believe, Invisicare® can differentiate and provide a competitive advantage to skincare products incorporating Invisicare®, thereby alleviating any competition from products with the same active ingredients.

***Applications – end-products***

Invisicare® has broad industry applications and can be used to improve performance of established prescription drugs as well as over-the counter (OTC) dermatological, medical, cosmetic and skincare products. Basically any company that manufactures topical products can be a potential client of Skinvisible.

As mentioned earlier, the company does not market their products themselves. They generate revenues by licensing products formulated with Invisicare® (proprietary products or products developed in collaboration with other companies) to pharmaceutical companies. The company also generates revenues by private labeling their proprietary products developed in-house. However, this revenue source only accounts for a small portion of the company's total revenues. In the next section, we present the company's different formulations (built in-house) and their revenue models.

### **Licensing Products Made With Invisicare®**

Skinvisible licenses its patented technology and formulated products to established developers and manufacturers of prescription and over-the-counter ("OTC") products in the dermatological, medical, cosmetic, and skincare markets. The licenses grant their clients the right to market the formulated product using Invisicare.

Improving the efficiency and effectiveness of their products is any pharmaceutical company's goal. However, that goal is of higher priority when companies find themselves with products that have reached the end of their patent life or face competition from similar products that have better features. Although improvements can be made by changing the active ingredients, they are not necessarily simple. Also, if only the active ingredients are changed, the product is most likely to face new competition from other products with similar active ingredients. **Therefore, pharmaceutical companies are now trying to improve their products by making changes in other components, like delivery systems.** Due to the high cost of drug approvals, one of the best ways to improve a drug is to incorporate a new drug delivery system.

We believe Invisicare® has relatively more benefits than other delivery systems in the market today. **An added benefit for companies utilizing Invisicare® is that as Invisicare® is patented, it allows for a new patent to be applied for, allowing for an enhanced product life cycle management, while keeping development costs to a minimum.** It is estimated that more than \$150 billion brand-name drug products will be coming off patent between 2005 and 2015 (according to NexMed), which means that all these drugs are actively seeking ways to extend their patent life.

There are basically two types of licensing.

1. Skinvisible's proprietary end-products
2. Clients bring their own proprietary (or soon off patent) active ingredient to Skinvisible. Skinvisible then works in collaboration with the client and develop an end product incorporating Invisicare®.

Both types of licenses incorporate Invisicare into the product formulations.

The company has developed a variety of proprietary products incorporating Invisicare® for licensing including:

- antimicrobial hand sanitizers (for avian bird flu and other viruses)
- acne
- antifungal
- atopic dermatitis
- analgesics
- anti-aging
- anti-inflammatory
- hyperpigmentation
- daily moisturizers
- sunless tanning products
- sunscreens

**Revenue model:** Licensing and royalty fees are typically negotiated based on:

1. Indication (i.e. an acne active ingredient)
2. Distribution (retail, commercial), and
3. Territory (country).

When Skinvisible licenses their technology, they get a license fee upfront (currently, Skinvisible has sold three licenses, two for \$1 million each; but we believe licensing fees can be increased as the company gets more market recognition in the future) and then ongoing royalty payments (ranging between 5% and 20% of product sales). Both, licensing and royalties have no associated operating costs, and therefore, these revenues have 100% gross margins. In the first nine months of FY2007, the company generated \$0.31 million in revenues from licensing and royalties, which represented about 51.5% of total revenues. This implies that more than half of the company's revenues have 100% gross margins, and makes the company's revenue model very attractive.

Once a product formulated with the technology is licensed, Skinvisible supplies polymers to licensees / manufacturers, and they incorporate the polymers into the product formulation that Skinvisible has provided them. Therefore, in addition to licensing and royalty fees, the company also generates revenues from sales of its polymers. In some cases, when a company agrees to incorporate Invisicare in its topical formulation, Skinvisible's chemists work in collaboration with these clients to develop the new formulation. Depending on the scope of the research, Skinvisible charges their clients a fee for product development. Although this revenue source only accounts for a small percentage of total revenues (approximately 2% of total revenues in FY2005), we believe, it is a good revenue model, as it allows the company to reduce their R&D expenses.

**Current licensed products (developed in-house):** Skinvisible currently has licensed four of their proprietary products in the following categories – antibacterial hand sanitizer lotions, sunless tanning mitts, topical analgesics and anti-acne (Adapalene). The table below shows a quick summary of the products that are currently available in the market.

Product category	Antibacterial Hand Sanitizer Lotion	Sunless Tanning	Topical Analgesics
<b>Brand Name</b>	Safe4Hours®	MitTan® by Solerra®	Stopain®
<b>Type</b>	Lotion	Tanning Mitt	Lotion
<b>Active Ingredient</b>	Triclosan	DHA	Menthol
<b>In the market since</b>	2004	2004	2007
<b>Patented</b>	Yes	Pending	No
<b>Licensed to</b>	JD Nelson & Associates	Sunless Beauty Inc.	DRJ Group
<b>Territory</b>	N America; seeking to establish relationships with potential distributors outside N.America	World	North America
<b>Revenues</b>	\$1 mm for licensing the technology, 5% royalties, and polymer sales	\$1 mm for licensing the technology, 5% royalties, and polymer sales	5% royalties, polymer sales, and development fees
<b>Availability</b>	marketed to the healthcare industry, food services, sports teams including many professional teams in the NHL, NFL and NBA, in the U.S.. It is also sold retail in Canada	Internet sales and retail spas in Canada and the U.S.	sold at many of the leading drugstores (15,000 stores) in the U.S., including Walgreens, Eckerd, CVS, Good Neighbor, Value Rite and Rite-Aid Pharmacies; also, many local pharmacies, vitamin and health food stores carry Stopain.



solerra



Stopain® is the company's top product at this time in terms of revenues. The brand is available in about 15,000 drug stores in the U.S. In addition to the above-mentioned three products, the company recently announced that they have signed an agreement to license their fourth product.

**Licenses its first acne product:** In January 2008, Skinvisible announced that they signed a licensing agreement with Panalab Internacional S.A., where Panalab will have the right to develop and commercialize the company's first acne product in Argentina, Brazil and Chile. Skinvisible's partner, Riley-Nacht, LLC, brought this agreement to them. According to the agreement, a multi-national dermatology company (headquartered in Panama with subsidiaries and partners in most Latin American countries) will be responsible for filing and obtaining marketing approval in the countries they have licensed. Like their other licensing agreements, Skinvisible will receive an upfront licensing fee and research and development fee, in addition to royalties from the sale of products. The actual payments are yet to be disclosed.

Skinvisible's acne product is formulated with Adapalene. Adapalene is a topical retinoid (one

class of acne products), and retinoids, according to Skinvisible, have a 60% market share in the \$2.8 billion worldwide acne market. In addition to its attractive market share, another reason why Skinvisible chose Adapalene as the active ingredient for its acne products is that Adapalene is coming off patent in 2010 in the U.S. It means that all the products that are formulated with Adapalene will be currently seeking ways to extend their patent life. Skinvisible has a patent application pending for their acne products. Due to its advantages, we believe Skinvisible's acne products can generate significant interest in other markets as well.

Although these four licensed products will contribute to revenue growth in the future, we believe, the primary growth drivers of the company are the products that are currently in the pipeline and ready to be licensed. A discussion of the products in pipeline is presented later in this report.

### Private Labeling Opportunities

In addition to licensing its technology and related compositions developed in-house, the company has also developed a variety of skincare products for private label commercialization to the healthcare, food service, industrial, cosmetic and beauty industries. These products target companies, like pharmacies, looking to add products under their own brand name. The products are non-exclusive, so companies are charged only for the final formulation, the actual license for the product will still be available for sale to another licensee. Skinvisible's private label products include antimicrobial hand sanitizers, sunless tanning sprays, sunscreens and skincare products.

**Revenues:** In the first nine months of FY2007, the company generated \$0.29 million (47.7% of total revenues) from product sales, which includes revenues from the sale of polymers (for their licensed products) and also from private labeled products. Since the company does not provide information on revenue distribution, we are not in a position to precisely estimate how much of the revenues came from private labeled products.

### Products in the Pipeline – The primary growth driver

Skinvisible has several products in the pipeline that they developed for a variety of topical skin applications and product development opportunities identified in collaboration with established manufacturers and marketers.

Category	Active Ingredients (number of products)	Rx/OTC/Cosmetic	Availability	Patent Status
1 Acne	4	Rx/OTC	3	Pending
2 Analgesics	3	OTC	3	Applying
3 Anti-aging	2	Cosmetic	1	Applying
4 Anti-fungal	5	Rx/OTC	3	Pending
5 Anti-inflammatory	5	Rx/OTC	5	Applying
6 Antimicrobial Hand Sanitizing Lotion*	4	OTC	2	Approved for three
7 Hyperpigmentation/Incontinence	1	Cosmetic	1	Applying
8 Moisturizers	3	Rx/OTC/Cosmetic	2	Pending
9 UVA Sunscreen	2	OTC	2	Pending
<b>Total</b>	<b>29</b>		<b>22</b>	<b>3</b>

\* One of the active ingredients is chlorhexidine, which is awaiting NDA and patent approvals.

In summary, the company has developed, or is in the process of developing products targeting nine different categories, with 29 different products (active ingredients), of which, 22 are currently available. Three of them have received patent approvals.

All of these products have been successfully tested in-house, and are currently ready to be licensed to established pharmaceutical, OTC, cosmetic or skincare manufacturers for clinical studies and commercialization. Although developed products are available for licensing, they require additional approvals for prescription and some OTC products. Cosmetic-type products, or products without therapeutic claims, are immediately available for market. The products in the pipeline, as we mentioned earlier, will be the company's primary growth drivers in the future. The company's long-term growth will depend heavily on the company's ability to license their products. Our talks with management indicated that the company is currently in discussions with several companies to license their Invisicare® technology.

Among the products that are waiting to be licensed, there is one product that deserves a special mention at this time, and we believe, has the potential to bring significant upside to the company going forward.

### **Chlorhexidine Antimicrobial Hand Sanitizer – DermSafe™: Product to Combat BirdFlu**

As the name suggests, this patent pending product's active ingredient is chlorhexidine, a substance that kills many disease causing bacteria and viruses including the bird flu H5N1 virus. Chlorhexidine is the active ingredient in most hospital antimicrobial hand soaps. The company's other hand-sanitizing product (Safe4Hours®) uses Triclosan as the active ingredient, which is currently facing concerns. Researchers have recently raised concerns about Triclosan primarily because of the acute health effects resulting from Triclosan exposure. Although this might put downward pressure on the company's Safe4Hours® product, we believe, the chlorhexidine hand sanitizer, named DermSafe™, has significant growth prospects.

Skinvisible spent about \$0.5 million over three years into research and development to develop DermSafe™. Independent *in vitro* tests (an artificial environment outside the living organism) performed in Retroscreen Laboratories in London, England (a subsidiary of University of London's Queen Mary School of Medicine) has demonstrated efficacy against the H5N1 avian flu virus at a 99% kill rate within seconds of contact. Further independent studies are being negotiated by a department (at the University Hospital, Geneva, Switzerland) that reports directly to the National Pandemic Center for the World Health Organization (WHO).

We believe this product could be an alternative to the alcohol hand sanitizers that are being used in hospitals today. According to Skinvisible, studies have shown a hand sanitizer without alcohol that can offer a four-hour kill on most bacteria and viruses would be widely accepted in the healthcare field. DermSafe™ has been approved for sale in Canada and the company is seeking to license the product for worldwide distribution. The company indicated to us that they have already received interest from China, India, S.E. Asia and Europe. The

product requires FDA approval as a new drug in the U.S.

### ***Patents and Trademarks***

Patent and other intellectual property protection of proprietary technologies are very important in this industry, especially for companies like Skinvisible, because of their unique polymer delivery technology. Skinvisible's future growth will depend heavily on their capability to obtain patents. In order to attract major pharmaceutical companies, it is important that the products are patent protected. Therefore, the company, like other companies with delivery platforms, intends to apply for patent approvals (initially in the U.S. and later in other countries where they intend to do business) for all the products that they develop. The earlier the company receives approvals, the earlier they will be able to license out their products.

The company has received approvals for the following patents:

- Received patent approval for its antimicrobial dermal barrier composition (No. 6,582,683) in June 2003.
- In August 2001, the company filed a patent application for the Invisicare® technology, titled “Topical Compositions, Topical Composition Precursors, and Methods for Manufacturing and Using”. The U.S. Patent and Trademark Office split this application into three different applications as follows: (a) Methods of Manufacturing (b) Topical Compositions and (c) Methods of Use. The company received approval for (a) and (b) (US Patent No. 6,756,059 and US Patent No. 10/154,723), and is awaiting approval for (c). Our discussions with management indicated that they are expecting approval for Part (c) in the next 12 months.
- In August 2007, Invisicare® received patent approval in India. We believe, India, with a population of over 1.1 billion people, is a key market for Skinvisible.

Skinvisible is awaiting patent approvals for the following.

- Approval of the Invisicare® technology from certain foreign countries
- Six U.S. patents, which cover sunless tanning spray formulas, sunless tanning lotion formulas, sunscreen formulas, anti-fungal formulas, acne formulas and hand sanitizers (DermSafe™).
- Applying for PCT patents for finished formulas in certain foreign countries.

**Trademarks:** Skinvisible also files for trademark protection (initially in the U.S. and later in other countries where they intend to do business) for their products. Skinvisible has been granted trademarks in the U.S. for the following names:

Skinvisible®, Invisicare®, Safe4Hours®, Work Gluv®, Solerra®, and DermSafe™

### ***Partners***

The company has three sales and marketing partners to assist them in selling their product formulations incorporating Invisicare® in different markets worldwide. A brief profile of the company's partners, as given by management, follows.

#### **1. EMD Chemicals Inc. of Hawthorne N.Y. (an affiliate company of Merck KGaA,**

**Darmstadt, Germany**), represents Skinvisible in the global Personal Care industry. EMD in turn receives commission income from Skinvisible.

2. **Riley-Nacht, LLC, a pharmaceutical consulting firm**, is a representative for Skinvisible, and its products and technology, with respect to international pharmaceutical and cosmeceutical companies. Their role is to foster licensing opportunities, acquisition inquiries and strategic partnerships which will enhance Skinvisible's revenue streams. The key personnel include Les Riley and Sergio Nacht. Both individuals each have 30+ years experience in the healthcare industry.
3. The third partner represents Skinvisible in India. **Avani International** will assist Skinvisible in seeking licenses in India for their topical products. Avani will also facilitate clinical studies and manufacturing in India. Avani's Affiliate, PDM Healthcare, has successfully marketed for over 300 contracted manufacturers, including: Pfizer, Dr. Reddy's, Smith & Nephew, Novartis, J&J, GSK, Ranbaxy, Wockhardt, Wyeth, & many others.

### ***Management and Board of Directors***

Brief biographies of the company's management, board of directors and advisors, as given by Skinvisible, follows.

#### **Management**

##### **Terry Howlett, President and Chief Executive Officer**

Mr. Howlett founded Skinvisible, Inc in 1998. With over 30 years of entrepreneurial and business management experience, he drives and directs the Company's development and technology vision. He is adept at guiding emerging and publicly traded start-up companies. Mr. Howlett's diversified background includes skills and strengths in market development, coupled with his impressive range of international contacts in dermatological, medical and financial arenas.

##### **James A. Roszell, Ph. D, Chemist**

Dr. Roszell is a doctoral chemist with over 35 years experience in product formulation, experimental design, analysis, and method validation. Since joining Skinvisible in 1998, he has been responsible for research and development of the Company's patented technology, related polymer delivery vehicles, product formulations and compositions. Dr. Roszell is a joint contributor to Skinvisible's Patent Number 6.756.059 and responsible for its pending patents.

##### **Teresa Petraia, Director R&D/Business Development**

Ms. Petraia is a formulation chemist with over 25 years experience in product formulation, experimental design, analysis, and manufacturing. She joined Skinvisible in 2006, after holding positions with companies such as Richardson-Vicks, Procter & Gamble, Benckiser Consumer Products, Beiersdorf and Combe, Inc. In these positions, she was responsible for the development of products such as Olay® MiniMate, Clearasil® acne products, Pantene® hair care; manufacturing technology of Nivea®, Eucerin® and Aquaphor® brands; product development of OTC brands such as Vagisil®, Lanacane®, Odor Eater's®, Scalpicin® and

numerous other household cleaning products. She maintains patents in these areas and has written industry papers. At Skinvisible, Ms. Petraia is responsible for sourcing business opportunities and developing innovative products using *Invisicare*.

**Arthur de Joya, C.P.A., Accounting Services & Financial – Acting CFO**

De Joya & Associates handles Skinvisible's accounting and financial requirements, with Mr. de Joya acting as financial consultant. Mr. de Joya received his B.S. in B.A. from the University of Nevada, Las Vegas in 1991 and is a Certified Public Accountant, licensed in the states of California and Nevada. His expertise primarily revolves around Securities and Exchange compliance and reporting for public companies, development companies, e-commerce and technology. He has over 10 years of experience in public accounting including KPMG LLP and McGladrey & Pullen, LLP and was a partner with a Las Vegas certified public accounting and consulting firm. Mr. de Joya is a member of the American Institute of Certified Public Accountants and the Nevada Society of Certified Public Accountants.

**Board of Directors**

**Terry Howlett, President & Chief Executive Officer/Chairman**

**Brian Piwek, Independent Director**

Brian Piwek 's experience and expertise is in the international retail industry. He was president of Overwaitea Foods supermarket from 1991 until 1997. In 1997, Brian accepted the position as Co-CEO with A&P Canada (The Great Atlantic & Pacific Tea Company Inc.) and in 2000 was appointed Chairman, President and CEO of A&P Canada. In late 2002, he moved to the U.S. as President and Chief Executive Officer of A&P US (NYSE: GAP) where he began the turnaround of North America's oldest retail food chain. Brian retired from A&P in July 2005. Brian has been recognized for his achievements throughout his career including "President of the Year" by the Jim Pattison Group for the outstanding financial performance of Overwaitea in 1993. Brian is an MBA graduate and has served on many voluntary boards.

**Greg McCartney, Independent Director**

Mr. McCartney is past President and Chief Executive Officer of Genesis Bioventures, a company he founded in 1997. He was previously owner and director of a private consulting firm specializing in financing and venture capital. Mr. McCartney has over 20 years of business experience working with both private and public companies in various manufacturing and technology-based industries.

**Advisors**

**Stuart Maddin, MD, FRCPC**

Dr. Maddin is one of North America's leading dermatologists. He is a founder and lecturer of numerous international symposia and has served as President of the Canadian Dermatology Association and as Secretary-General of the International Committee of Dermatology – International League of Dermatological Societies. He sits on most major international pharmaceutical and cosmetic company advisory boards, is the founder and Editor-in-Chief of

*Skin Therapy Letter*®. He is the Chairman of SkinCareGuide. Dr. Maddin is an advisor to a number of drug regulatory agencies, such as the Health Protection Branch (Canada), the AAD-FDA Liaison Committee (U.S.A.) and WHO (Switzerland) and is the author of numerous scientific publications and more than twelve dermatology textbooks.

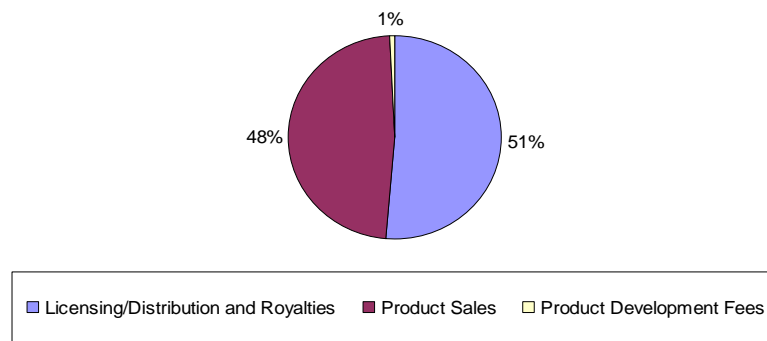
### **George J. Korkos, MD**

Dr. Korkos is a nationally renowned plastic and reconstructive surgeon. He is a graduate from the Medical College of Wisconsin and did his plastic surgery residency at St. Louis University. Dr. Korkos is currently the President of Plastic Surgery Associates in Milwaukee, Wisconsin and Blue Mound Surgery Center. Besides being an Associate Clinical Professor at the Medical College of Wisconsin, he was recently honored with the first endowed chair at the Medical College of Wisconsin: The George J. Korkos Chair in Plastic Surgery. Along with sitting on Boards of emerging companies and past service on Boards of a number of financial and investment institution, Dr. Korkos have diverse business background and medical expertise in assisting Skinvisible to bring its products and investment story to the investment community.

### **Financials**

The company generates revenues primarily from four sources: licensing, royalties, product sales (polymer and products), and product development fees. Licensing and royalties contributed 51.5% of total revenues, while product sales contributed 47.7% of revenues in the first nine months of FY2007. Product development fees only accounted for 0.8% of total revenues.

**Revenue Distribution (FY2007 - 9 mo)**



The table below shows the company's revenues since FY2004.

Revenues	2004A	2005A	2006A	2006 - 9 mo	2007 - 9 mo
Licensing/Distribution and Royalties	325,000	556,000	434,333	415,000	308,829
Product Sales	174,020	273,520	257,119	210,378	286,189
Product Development Fees*	20,952	20,760	-	24,000	4,603
<b>Total Revenues</b>	<b>519,972</b>	<b>850,280</b>	<b>691,452</b>	<b>649,378</b>	<b>599,621</b>

\* FRC Estimates

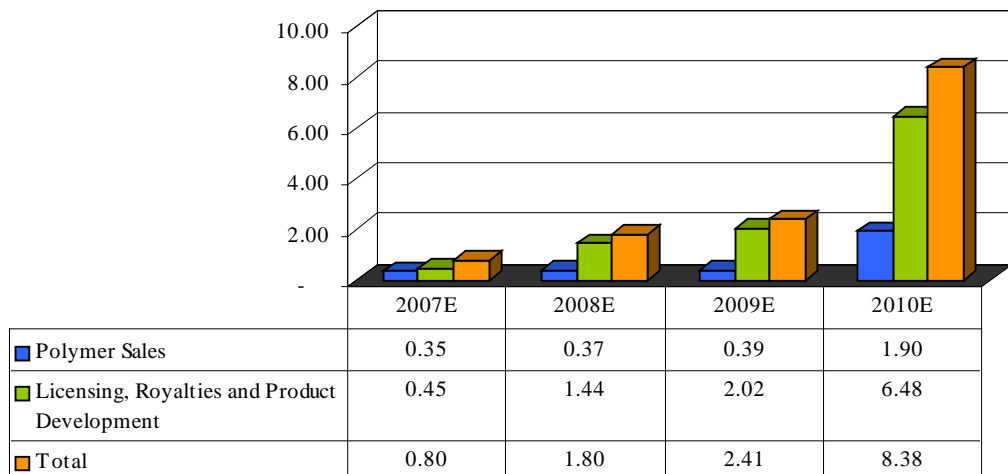
Over the long-term, revenues increased from \$0.06 million in FY2001, to \$0.69 million in FY2006, which reflects a CAGR of 65%. Revenues grew YOY every year during FY2001 – FY2005, but dropped in FY2006 due to a shift in the company's business from primarily

selling packaged products to only polymers, which generate lower revenues. The company granted their two major licensees the rights to manufacture finished product formulations themselves, which resulted in the shift in the business. However, revenues from polymer sales have higher gross margins than product sales. As a result, gross margins improved from 83.5% in FY2005, to 88.8% in FY2006.

Revenues continued to drop in FY2007, this was due to a drop in licensing and royalty fees. In the first nine months of FY2007, the company generated \$0.60 million in revenues versus \$0.65 million in the comparable period in the previous year, a decrease of 7.7%. Although product sales improved by 36% YOY, licensing and royalty fees dropped by 26%, which resulted in the overall drop in revenue growth. As licensing and royalty revenues dropped (this means revenues with zero operating costs dropped), gross margins also dropped YOY from 88.7% to 83.1%.

**Revenue forecasts:** Although revenues have dropped YOY since FY2005, we are not overly concerned, primarily because we believe revenues will increase as the company signs more licensing deals with distributors going forward. The chart below shows our revenue forecasts through FY2010.

Revenue Projections (in \$ mm)



■ Polymer Sales ■ Licensing, Royalties and Product Development ■ Total

Our revenue forecasts were based on the following assumptions:

- Assumed that the company will be able to license products in two categories in FY2008.
- Licence fees are calculated at 25% in each of the first two years and 50% in the third year.
- Product approvals will take two years.
- Assumed that the company will be able to license only 50% of the products in each of the nine categories (applications) in the pipeline, for conservatism.
- Assumed that sales of each of its products will steadily increase to a maximum of 50% of

established products' sales by the fifth year.

- Revenues from royalties and polymer sales from the currently licensed products will grow by 5% YOY over our forecast period.

Even though management strongly believes that they will be able to license their products at a much faster rate, and at higher licensing fees (our model conservatively assumes a \$1 million licensing fee and 5% royalties for each product category), we prefer to be conservative at this time. We will make revisions to our forecasts as the company signs more agreements.

**Margins:** The table below shows margins since 2004.

Margins	2001A	2002A	2003A	2004A	2005A	2006A	2006 - 9 mo	2007 - 9 mo
Gross	85.2%	72.7%	29.8%	81.4%	83.5%	88.8%	88.7%	83.1%
EBITDA	-2652.1%	-430.1%	-688.9%	-133.4%	-89.1%	-265.6%	-245.0%	-162.7%
EBIT	-2793.4%	-465.8%	-720.8%	-154.8%	-121.5%	-303.4%	-275.2%	-195.1%
EBT	-2793.4%	-465.8%	-675.4%	-154.8%	-121.3%	-303.4%	-275.2%	-195.1%
Net	-2793.4%	-465.8%	-675.4%	-154.8%	-121.3%	-303.5%	-275.2%	-194.7%

*Note: Gross margins in FY2003 were unusually low, as the company posted an inventory write-off in the amount of \$0.04 million plus increased product material costs during the period. .*

EBITDA and EBIT margins have been negative since inception because gross profits have not been able to offset the company's selling, general and administrative (SG&A) expenses. SG&A expenses were \$1.47 million in the first nine months of FY2007, versus \$2.17 million in the comparable period in the previous year. However, SG&A expenses in FY2006 are not really comparable figures, as they were unusually high due to increased expenses with respect to the research and development of the Chlorhexidine antimicrobial hand sanitizer lotion and stock based compensation issued to EMD pursuant to a distribution agreement entered into in October 2005.

**Net loss:** After amortization expenses and gains from foreign exchange translations, the company recorded a net loss of \$1.17 million (EPS: -\$0.02) in the first nine months of FY2007, versus \$1.79 million (EPS: -\$0.03) in the comparable period in the previous year. The company had posted a net loss of \$2.10 million in FY2006 (EPS: -\$0.03).

Our forecasts for FY2007, and FY2008, are net losses of \$1.27 million (EPS: -\$0.02) and \$0.58 million (EPS: -\$0.01), respectively.

**Cash Flows:** Although Skinvisible posted a net loss of \$1.17 million in the first nine months of FY2007, the company spent only \$0.57 million on operations, as \$0.69 million of the expenses were non-cash (amortization, stock based compensation and interest expenses). The table below shows the cash cycle, which is unusually low, as accounts payable days are much higher relative to days sales outstanding and inventory days.

	2002A	2003A	2004A	2005A	2006A
Days Sales Outstanding	52	69	17	32	41
Inventory Days	903	269	357	242	228
Days Payables Outstanding	3,230	1,526	1,925	719	1,192
Cash Cycle	-2,275	-1,188	-1,551	-445	-923

Skinvisible spent \$4,662 on investing activities in the first nine months of FY2007. Cash required for operating and investing activities were funded by equity (\$0.20 million), debt (\$0.33 million) and cash on hand at the end of FY2006.

**Cash Position and Liquidity:** The table below shows the company's cash and liquidity position.

	2002A	2003A	2004A	2005A	2006A	2007 - Q3
Working Capital	(386,122)	(613,450)	(721,254)	(941,096)	(1,043,664)	(1,210,058)
Current Ratio	36.9%	14.6%	25.6%	20.6%	9.2%	6.3%
Debt / Capital	12.6%	5.5%	0.0%	0.0%	-10.9%	-53.6%
Debt / Equity	14.4%	5.9%	0.0%	0.0%	-9.8%	-34.9%
Interest Coverage Ratio (EBIT)	-	-	-	-	-	-

At the end of September 2007, the company had cash and a working capital deficit of \$2,894 and \$1.21 million, respectively, versus \$0.05 million and \$1.04 million at the end of FY2006.

Skinvisible issued convertible debentures of \$0.25 million in the first nine months of FY2007, due by the end of FY2007, and increased related party loans by \$0.08 million (although they are only due on demand, they are categorized as current liabilities). As a result, the company's debt level increased from \$0.03 million (Debt to Equity: -9.8%) to \$0.22 million (Debt to Equity: -34.9%).

The company's shareholders' equity is negative (-\$0.62 million) because its accumulated deficit is higher than share capital and contributed surplus, which explains why their debt to equity ratio is negative.

**Stock Options and Warrants:** At the end of September 2007, the company had 5.98 million stock options and 3.17 million warrants outstanding, with weighted average exercise prices of \$0.16 per share and \$0.11 per share, respectively.

**Conclusion:** Since potential clients will pay Skinvisible to develop formulations (as product development fees) incorporating Invisicare®, SKVI's business model is not very capital intensive, which minimizes any risks arising from debt and share dilution. However, we estimate that the company will have to raise money to fund their working capital until they become cash flow positive in FY2010. Our models suggest that the company will have to raise an additional \$0.18 million in Q4-2007, or reduce the cash cycle further to fund their working capital.

## Valuation

Our Discounted Cash Flow (DCF) valuation of the company's equity is \$65.20 million, or \$1.00 per share (shown below).

DCF Valuation Model (in US\$)										
	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F	Terminal
<b>FFO</b>	(530,143)	(150,303)	110,669	5,646,613	7,456,626	10,079,070	8,822,120	11,514,088	13,440,432	14,957,057
-increase in w/c	(196,794)	(497,998)	(486,387)	(215,960)	20,813	(115,029)	224,754	(47,499)	(43,796)	(34,195)
<b>=CFO</b>	(726,937)	(648,301)	(375,718)	5,430,652	7,477,439	9,964,041	9,046,874	11,466,588	13,396,636	14,922,862
-capex	(6,216)	(25,000)	(25,000)	(25,000)	(25,000)	(25,000)	(25,000)	(25,000)	(25,000)	(25,000)
<b>FCF</b>	(733,153)	(673,301)	(400,718)	5,405,652	7,452,439	9,939,041	9,021,874	11,441,588	13,371,636	14,897,862
<b>PV</b>	<b>(733,153)</b>	<b>(586,239)</b>	<b>(303,787)</b>	<b>3,568,155</b>	<b>4,283,111</b>	<b>4,973,597</b>	<b>3,930,864</b>	<b>4,340,531</b>	<b>4,416,785</b>	<b>41,523,189</b>
Discount Rate	14.9%									
Terminal Growth	3.00%									
Sum PV	\$65,413,054									
Cash	\$2,894									
Debt	\$215,718									
PV Equity	\$65,200,230									
Shares O/S	65,345,206									
<b>Value per share</b>	<b>\$1.00</b>									
<b>Weighted Average Cost of Capital (WACC)</b>										
Cost of Equity*	15.8%									
Cost of Debt	10.0%									
Debt / Capital (long-term avg)	10.0%									
Equity / Capital (long-term avg)	90.0%									
Tax	36.0%									
<b>WACC</b>	<b>14.9%</b>									

\* Average cost of equity of the healthcare industry (Yahoo Finance)

We also performed a relative analysis of the company's price to sales (P/S) ratio relative to its peers. All the comparables have negative EBITDA and EPS, which is why we used the P/S ratio.

Comparables (in \$ mm)	Market Cap	Sales	EBITDA	Net Income	P/S
NexMed (NEXM)	\$131.82	\$1.30	(\$7.98)	(\$8.22)	101.4
A.P.Pharma (APPA)	\$43.11	\$5.39	(\$8.47)	(\$8.21)	8.0
Flamel Technologies, Inc. (FLML)	\$210.60	\$33.88	(\$34.80)	(\$37.66)	6.6
Noven Pharmaceuticals, Inc. (NOVN)	\$316.48	\$77.21	(\$94.95)	(\$39.31)	4.1
SkyePharma (SKYE)	\$195.60	\$100.11	(\$95.98)	(\$127.06)	2.0
<b>Industry (Pharmaceuticals - Generic / Specialty)</b>					<b>7.2</b>
Skinvisible Inc. (SKVI)*					
based on FY2008E sales	\$7.84	\$1.57	(\$0.29)	(\$0.50)	5.0
based on FY2010E sales	\$7.84	\$7.67	\$4.40	\$4.39	1.0

\* Sales, EBITDA and Net Income forecasts were discounted at cost of capital

As shown in the table, the company's P/S based on our revenue forecasts for FY2008 and FY2010 (discounted at their cost of capital) are 5.0 and 1.0, respectively, versus the industry average P/S of 7.2. Therefore, our relative analysis clearly indicates that the company is undervalued compared to its peers.

### Conclusions and Rating

**Based on our valuation models and the potential of the company's technology, we place a fair value estimate of \$1.00 per share on SKVI and initiate coverage at a BUY.**

We believe the company's current and short-term revenues and EPS forecasts do not reflect its true potential, which is why we did not estimate a fair value on the company based on our relative analysis. However, it is worth noting that the company is undervalued even based on our FY2008 sales forecasts, which is a clear sign that the current share price does not account

for the company's upside potential.

We believe the company is well positioned for long-term growth based on its unique delivery system, its broad pipeline of end products, and an attractive revenue model. We reiterate that the company's growth depends heavily on its ability to license out its products. However, we believe we have used conservative estimates and assumptions in our valuation model to account for the risks involved. Upside potential will arise as the company signs more licensing agreements and receives patent approvals.

### ***Risks***

The following factors, though not exhaustive, will cause our estimates to differ from actual results:

- Market recognition and brand awareness are key factors that will impact long-term growth prospects.
- Ongoing success depends on achieving innovative polymer delivery results, licensing agreement negotiations, royalty revenues, various patents pending, as well as their legalities, and conformance to any regulatory and environmental requirements.
- Our revenues and EPS projections depend heavily on the company's ability to license their products.
- Delay in approvals of the pending patents will put downward pressure on our revenue forecasts.

**We rate the company's shares Risk 4 (Speculative).**

**CONSOLIDATED STATEMENT OF OPERATIONS**

Year ended December 31

(expressed in US\$)

	<b>2003A</b>	<b>2004A</b>	<b>2005A</b>	<b>2006A</b>	<b>2007F</b>	<b>2008F</b>
Revenues	193,988	519,972	850,280	691,452	796,102	1,803,194
Cost of revenues	136,125	96,781	140,399	77,465	147,594	133,316
<b>Gross profit</b>	<b>57,863</b>	<b>423,191</b>	<b>709,881</b>	<b>613,987</b>	<b>648,509</b>	<b>1,669,878</b>
SG & A	1,394,272	1,116,824	1,467,429	2,450,596	1,667,084	2,000,501
<b>EBITDA</b>	<b>(1,336,409)</b>	<b>(693,633)</b>	<b>(757,548)</b>	<b>(1,836,609)</b>	<b>(1,018,575)</b>	<b>(330,622)</b>
Amortization and Depreciation	61,815	111,339	275,710	261,187	249,104	249,369
<b>EBIT</b>	<b>(1,398,224)</b>	<b>(804,972)</b>	<b>(1,033,258)</b>	<b>(2,097,796)</b>	<b>(1,267,679)</b>	<b>(579,991)</b>
Other income (expense)	87,984		2,107	192		
Interest Income (expense)	20					
<b>EBT</b>	<b>(1,310,220)</b>	<b>(804,972)</b>	<b>(1,031,151)</b>	<b>(2,097,604)</b>	<b>(1,267,679)</b>	<b>(579,991)</b>
Taxes					-	-
Foreign currency translation adjustment			-	(672)		
<b>Net Income</b>	<b>(1,310,220)</b>	<b>(804,972)</b>	<b>(1,031,151)</b>	<b>(2,098,276)</b>	<b>(1,267,679)</b>	<b>(579,991)</b>
EPS	(0.03)	(0.01)	(0.02)	(0.03)	(0.02)	(0.01)
Number of common shares outstanding	43,218,767	55,625,248	57,263,522	61,925,163	63,503,206	65,081,248

**CONSOLIDATED BALANCE SHEET**

As at December 31

(expressed in US\$)

	2003A	2004A	2005A	2006A	2007F	2008F
<b>ASSETS</b>						
<b>Current</b>						
Cash	-	92,434	30,729	50,070	17,411	44,110
Accounts receivables	28,177	19,940	127,989	28,812	86,510	195,948
Inventory	76,688	112,642	73,794	22,902	39,805	90,160
Due from related party		21,126	4,765	1,119	1,196	1,196
Prepaid expenses & others		1,921	6,344	3,461	4,152	9,404
<b>Total current assets</b>	<b>104,865</b>	<b>248,063</b>	<b>243,621</b>	<b>106,364</b>	<b>149,074</b>	<b>340,818</b>
Fixed Assets	78,685	47,894	26,480	29,652	31,420	51,707
Deposits						
Patents and trademarks	27,946	61,613	51,394	41,175	36,519	31,863
License and distributor rights	50,000	50,000	50,000	50,000	50,000	50,000
Prepaid royalty fees	1,200,000	1,140,000	900,000	660,000	420,000	180,000
<b>Total Assets</b>	<b>1,461,496</b>	<b>1,547,570</b>	<b>1,271,495</b>	<b>887,191</b>	<b>687,013</b>	<b>654,388</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>						
<b>Current</b>						
Bank overdraft	762					
Accounts payable and accrued liabilities	674,690	346,317	206,717	299,300	590,376	489,603
Accrued interest payable						
Loan from related party	42,863			25,728	103,222	103,222
Convertible notes payables					150,000	150,000
Unamortized debt discount						
Unearned revenues		623,000	978,000	825,000	412,500	180,319
<b>Total current liabilities</b>	<b>718,315</b>	<b>969,317</b>	<b>1,184,717</b>	<b>1,150,028</b>	<b>1,256,098</b>	<b>923,144</b>
Long-term liabilities						
<b>Total liabilities</b>	<b>718,315</b>	<b>969,317</b>	<b>1,184,717</b>	<b>1,150,028</b>	<b>1,256,098</b>	<b>923,144</b>
<b>Shareholders' equity (deficiency)</b>						
Equity	10,499,380	11,139,424	11,544,227	13,427,761	13,800,761	14,500,761
Stock subscription payable			134,873			
Accumulatd other comprehensive income				(672)	587,760	768,079
Accumulated Profit (Deficit)	(9,756,199)	(10,561,171)	(11,592,322)	(13,689,926)	(14,957,605)	(15,537,597)
<b>Total shareholders' equity (deficiency)</b>	<b>743,181</b>	<b>578,253</b>	<b>86,778</b>	<b>(262,837)</b>	<b>(569,084)</b>	<b>(268,756)</b>
<b>Total Liabilities and Shareholder's equity</b>	<b>1,461,496</b>	<b>1,547,570</b>	<b>1,271,495</b>	<b>887,191</b>	<b>687,013</b>	<b>654,388</b>

**CONSOLIDATED STATEMENT OF CASH FLOWS**

Year ended December 31

(expressed in US\$, 000's)

	2003A	2004A	2005A	2006A	2007F	2008F
<b>OPERATING ACTIVITIES</b>						
<b>Net income (loss)</b>	(1,310,220)	(804,972)	(1,031,151)	(2,097,604)	(1,267,679)	(579,991)
<b>Add (deduct) non-cash items</b>						
Depreciation and amortization	61,815	111,339	275,710	261,187	249,104	249,369
Stock based compensation	378,252	32,150	241,803	859,160	284,838	180,319
Stock issued for donation						
Others	12,016					
Interest expense					203,594	
<b>Funds from Operations</b>	<b>(858,137)</b>	<b>(661,483)</b>	<b>(513,638)</b>	<b>(977,257)</b>	<b>(530,143)</b>	<b>(150,303)</b>
<b>Changes in working capital</b>						
Inventory	47,018	(35,954)	38,848	50,892	(16,903)	(50,355)
Accounts receivables	16,596	8,237	(108,048)	99,177	(57,698)	(109,438)
Prepaid expenses and others	3,088	(1,921)	(4,423)	2,883	(691)	(5,252)
Related party receivables	-	(21,126)	16,361	3,646	(77)	-
Deposits	225					
Bank draft	(762)					
Accounts payables and liabilities	309,527	(371,998)	11,399	111,584	291,076	(100,773)
Accrued interest						
Unearned revenues	-	623,000	355,000	(153,000)	(412,500)	(232,181)
	<b>375,692</b>	<b>200,238</b>	<b>309,137</b>	<b>115,182</b>	<b>(196,794)</b>	<b>(497,998)</b>
<b>Cash flow from operations</b>	<b>(482,445)</b>	<b>(461,245)</b>	<b>(204,501)</b>	<b>(862,075)</b>	<b>(726,937)</b>	<b>(648,301)</b>
<b>FINANCING ACTIVITIES</b>						
Proceeds from related party loans				25,728	77,494	
Proceeds from convertible notes payables	31,739				250,000	
Proceeds from stock subscription payables			134,873			
Proceeds from issuance of common stock	405,000	607,894	12,000	870,500	373,000	700,000
<b>Cash provided by financing activities</b>	<b>436,739</b>	<b>607,894</b>	<b>146,873</b>	<b>896,228</b>	<b>700,494</b>	<b>700,000</b>
<b>INVESTING ACTIVITIES</b>						
Purchase of fixed assets and intangible assets		(54,215)	(4,077)	(13,847)	(6,216)	(25,000)
Proceeds from disposal of fixed assets	41,084					
<b>Cash used in investing activities</b>	<b>41,084</b>	<b>(54,215)</b>	<b>(4,077)</b>	<b>(13,847)</b>	<b>(6,216)</b>	<b>(25,000)</b>
<b>Exchange rate changes</b>				<b>(965)</b>		
<b>Increase in cash and cash equivalents</b>	<b>(4,622)</b>	<b>92,434</b>	<b>(61,705)</b>	<b>19,341</b>	<b>(32,659)</b>	<b>26,699</b>
Cash and cash equivalents, beginning of year	4,622	-	92,434	30,729	50,070	17,411
<b>Cash and cash equivalents, end of year</b>	<b>-</b>	<b>92,434</b>	<b>30,729</b>	<b>50,070</b>	<b>17,411</b>	<b>44,110</b>

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