



CogState Limited (CGS)

Speculative Buy

Initiating Coverage; Clinical Trial Focus Bearing Fruit

\$0.10

Thomas Duthy *PhD MBA*
tduthy@taylorcollison.com.au
+61 2 9232 1688

Key Points

CogState's main business focus is to supply some of the world's largest pharmaceutical and functional food companies with computer-based cognitive testing services.

The Company has ceased R&D expenditure on non-core drug development projects to focus on the clinical trial testing market.

The Company derives the bulk of its clinical trial testing revenues from Pfizer, Inc.

1H06 result of 55.3% product revenue growth and an NPAT loss down 11.6% highlights turnaround of the business is on track.

Summary

Market Capitalisation (M)	\$3.9
Share Price	\$0.10
Valuation Per Share	\$0.35
Est. Pro-forma Cash (M)*	\$2.8
Est. Cash Burn Per Quarter (M)	\$0.7
Year High	\$0.21
Year Low	\$0.07
Market Cap: Cash Ratio	1.4
Market Cap: Cash Ratio (Sector)	14.2

* Post rights issue to raise \$0.53 million after costs

Key Financials (A\$'000)

Year End	2005 Actual	2006 Est.	2007 Est.
Revenue	1,525	2,538	4,322
Net Op. Rev	(2,302)	(1,808)	184
R&D Expenses	(260)	(275)	(289)
EBITD	(2,783)	(2,222)	(173)
EBIT	(2,897)	(2,273)	(250)
NPAT pre Net R&D	(2,308)	(1,598)	440
Reported Profit	(2,279)	(1,787)	152
Reported EPS (c)	(6.4)	(4.6)	0.3
PE Ratio (x)	n/a	n/a	29.3
EPS pre R&D (c)	(6.5)	(4.1)	1.0
PE Ratio pre R&D (x)	n/a	n/a	10.0

Share Price Graph (A\$)



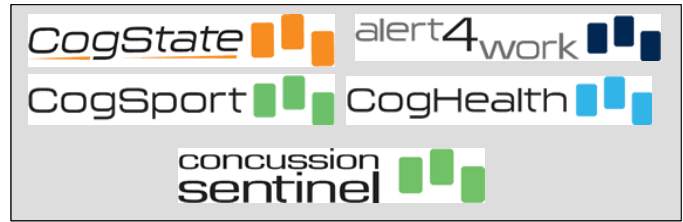
Our View

- CogState has significantly underperformed the market since its IPO in February 2004. We view the recent management changes, cost control initiatives and renewed focus on the attractive cognition testing market for clinical trials as the basis for a turnaround and future outperformance. On a macro level, there is an impetus in the clinical trial setting to move from antiquated cognitive testing by "pencil and paper" tests to computer-based tests. We view the current value ascribed to the CogState business does not reflect the key revenue growth expected in the clinical trial testing market.
- CogState has five revenue generating products, viz ClinIT, CogHealth, CogSport, Concussion Sentinel and Alert 4 Work. We note that ClinIT comprised the bulk (82%) of FY05 revenues, and is expected to do so into the future. We estimate the potential Central Nervous System (CNS) Phase 1 testing market for cognition at US\$28 million and US\$62 million for Phase 2/3 testing. Based on FY05 product sales, overall penetration remains at 0.7% (in A\$ terms). Given the growth in CNS specific clinical trials, and the validation of the testing battery provided by the Pfizer partnership, we believe there is opportunity for business expansion in these markets.
- We are forecasting an FY06 NPAT loss of \$1.8 million on revenues of \$2.5 million in FY06 (up 66.4% pcp), increasing 70.2% pcp to \$4.3 million in FY07. We expect the Company to turn a maiden profit in FY07 of \$0.15 million. Our DCF analysis values the Company at \$15.6 million, or \$0.35 per share (fully diluted), which is a significant premium to the current price. With a pro-forma EV of just \$1.6 million, we believe CogState remains undervalued and therefore initiate research coverage with a Speculative Buy recommendation and a price target of \$0.35.

CogState Business Summary

Focus on cognition testing.

CogState's main business focus is to supply some of the world's largest pharmaceutical and functional food companies with cognitive testing. CogState has five revenue generating products, namely ClinIT, CogHealth, CogSport, Concussion Sentinel



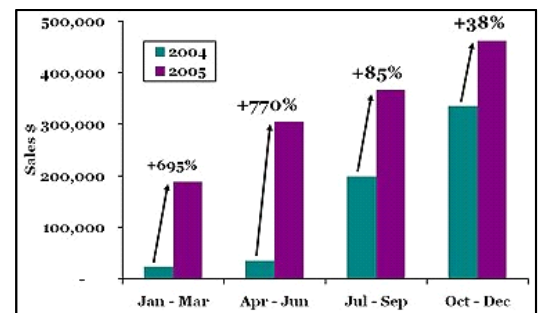
82% of product revenue from clinical trial testing market.

and Alert 4 Work (see across). However, it is important to recognise that ClinIT comprised the bulk (82%) of FY05 revenues, predominately through a relationship with the world's biggest pharmaceutical company Pfizer, Inc. We believe it is imperative for CogState to diversify this revenue source by seeking cognition testing contracts from other pharmaceutical, biotechnology or functional food/nutraceutical companies.

Relationship with Pfizer, Inc.

The Company recently ceased its two in-house drug development projects and is currently seeking to out-license these early stage projects to third parties. Given the Company's core skill base is in cognition testing, we view this restructure as a key positive. CogState is now focused on revenue growth in the key clinical trial testing markets, which has shown strong quarter on quarter over CY05, and well above corresponding CY04 sales (see across).

Quarter on quarter sales growth recorded.



Source: CogState

Management and Scientific Expertise

Significant scientific expertise.

One of the keys to CogState's future success is the maintenance of the significant scientific and technical expertise built around the battery of cognition tests. In short, the Company has retained four world leaders in cognition, with over 300 peer-reviewed papers between them. We understand these personal are predominately responsible for the key contracts signed with large pharmaceutical companies such as Pfizer.

The Company has also recently appointed Brad O'Connor as CEO, after the previous CEO resigned. As part of the restructure, the Company announced the expansion of operations in the UK and the USA (partly funded by Pfizer), targeting predominately further clinical trial cognition testing contracts. We view this as the key, high growth market segment for CogState. Head count has also been reduced from 21 to 14 full time employees.

Examining the Technology Platform

It is important to understand that cognition testing is not a new science. Cambridge Psychometric Consultants define the term 'cognitive testing' as the process of measuring an individual's ability to think, solve problems, concentrate, remember and respond. These cognitive processes underpin our everyday behaviour and can be affected by disease, injury, drugs and even mood. Damage to the brain, whether by disease or injury, can often give rise to problems with cognition.

CogState believe the absolute key differentiators, and sustainable competitive advantage of the test (particularly in the clinical trial setting) can be attributable to:

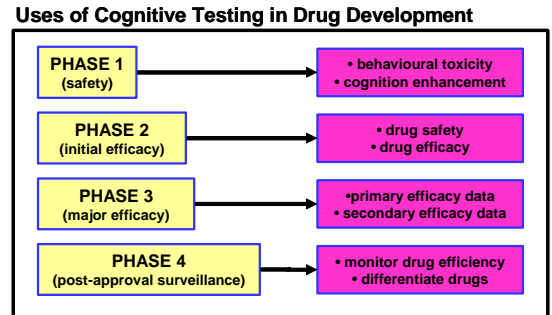
Six main advantages of CogState's cognition battery.

1. Rapidity of the test (12 minute battery of tests), which makes it ideal for drug development trials;
2. Real time scoring and centralised reporting of test results;
3. Validation provided by over 50 peer-reviewed publications and over 21 clinical trials by world leading pharmaceutical companies (including Pfizer);
4. Sensitivity that allows for detection of cognitive improvement in healthy patients and changes in diseased/disordered patients (crucial for drug intervention therapy);

5. Expert input from in-house clinicians; and
6. Removes errors associated with older 'pencil and paper' tests.

ClinIT in CNS Clinical Trials: Significant Opportunities

More recently, CogState has focused on the far more lucrative clinical trial testing market for applications of its core technology. Cognition testing in drug development has become a major recent impetus, largely due to the publication of regulatory guidelines (both FDA and EMEA) specifying the use of cognitive testing in the development of drugs for Alzheimer's disease, schizophrenia, Parkinson's disease, epilepsy and a number of other disorders. This has led to the widespread use of cognition testing in these markets, and more recently many others. Cognition testing can be utilised at all clinical stages of drug development as shown in the Table (across). FY05 sales of ClinIT were \$0.84 million significantly up from FY04 sales of just \$17,635.



Source: Adapted from Cambridge Psychometric Consultants

Cognition testing required for a range of CNS diseases and disorders.

CNS remains an attractive clinical trial space.

Phase 1 market worth US\$28 million and Phase 2/3 US\$62 million.

The maturation of currently marketed CNS drugs coupled with significant patent expiry events over the next few years has led to an ever increasing number of therapeutic drugs in the CNS space entering clinical trials. We believe the growth has also been fuelled by newer and better drug design and synthesis technologies. For example, the number of Investigational New Drug (IND) applications submitted to the FDA in 2002 to 2003 was up 10.4% for CNS drugs, compared with only 7.3% for the next best disease class. Overall, clinical trial numbers and spending just in the US is on the increase and is expected to grow 12.3% per year through 2007 to US\$26.5 billion.

We believe the Phase 1 testing market for cognition could be worth approximately US\$28 million and US\$62 million for Phase 2/3 testing. Based on FY05 product sales, overall penetration by CogState in this market remains at 0.7% (in A\$ terms). Given the growth in CNS specific clinical trials, and the validation of the testing battery provided by the Pfizer partnership (see below), we believe there is opportunity for business expansion in these markets.

Disease/Disorders Where Cognition Testing is Utilised

We see the large, key testing markets where positive cognition is a desired endpoint in clinical studies as schizophrenia, depression, epilepsy and to a lesser extent, Alzheimer's Disease (see across). At present, there are a significant number of clinical trials being conducted, at various stages.

Examining Major CNS Disease Clinical Trials (USA only)

Indication	2003 Market Size (US\$m)	Phase 1	Phase 2	Phase 3
Schizophrenia	10,600	33	32	75
Epilepsy	7,400	17	26	32
Depression	15,500	64	100	127
Alzheimer's	1,600	19	32	26

Source: PharmaVoice, US Govt.

Significant clinical trials undertaken in CNS space.

ADHD and CABG indications also attractive.

Examining the present diseases/disorders where the CogState test has been utilised, we note a further nine indications where the test could be useful. Other potentially lucrative positive cognitive testing markets include Attention Deficit Hyperactivity Disorder (ADHD), where 65 Phase 1-3 trials are presently being conducted and Coronary Artery Bypass Graft (CABG) surgery (56 studies).

Phase 1 - 3 Trial Contracts – Cumulative Growth Recorded

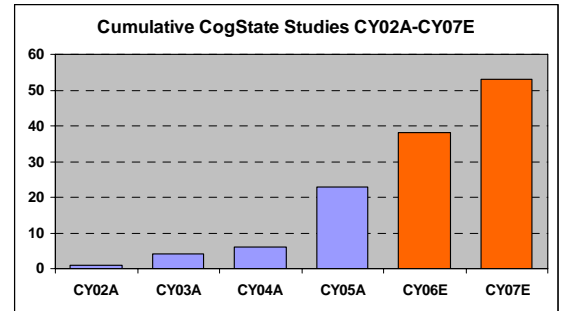
CogState has indicated that the majority of its clinical revenues have come from undertaking Phase 1 trials, mostly through Pfizer. CogState has indicated that contract sizes for Phase 1 are US\$20-60,000 and for a small Phase 2 approximately US\$80-90,000. Larger Phase 2 and Phase 3 studies typically command around US\$300-350,000. For reasons more fully explained in the next section, despite the lower revenues CogState can expect to achieve at

CogState has recorded growth in the use of cognition tests in clinical trials.

Phase 1 versus Phase 2/3, our analysis has indicated that as the Phase 1 drugs move further through the clinical trial process, CogState can also expect its testing battery to be embedded within each stage of the process as well.

21 clinical trials and 44 other studies.

Since first commencing sales into the clinical trials market in 2004, CogState technology has been included in 21 clinical trials and 44 other studies. The cumulative number of clinical trials that utilises ClinIT in our view reinforces the independent application of the technology and validation associated thereof. Perhaps more importantly it allows regulatory bodies such as the FDA to become more comfortable with the modernisation of cognition tests, rather than the traditional paper and pencil tests that have been in existence for many decades and are prone to significant errors. The chart above highlights the total drug trials to date that has used CogState cognition tests.



Real Barriers to Entry Exist From Phase 1 Onwards

Locking into Phase 1 clinical trials can see downstream use of test in Phase 2/3.

While a battery of cognition tests does exist, we understand that if a drug is being trialled for a positive effect on cognition at an early stage (e.g. Phase 1), it is essential to utilise the same testing regime through efficacy (Phase 2 and 3) trials. Our rationale for this observation is due to the high regulatory frameworks under which clinical trials are conducted, coupled with the desire to maintain absolute consistency in methodology. In some respects, the switching costs are not dissimilar to that of GroPep (ASX:GRO), who supply an ingredient in the manufacture of drugs through clinical trials.

64% of CNS drugs in Phase 1 will move to Phase 2.

Given the majority of CogState's clinical trial testing has been at Phase 1, we expect further contracts moving forward from the same end users. We note at least one Phase 3 trial with Pfizer has been entered into previously. Based on the analysis of clinical success for CNS drugs, we can expect that over 64% of the drugs tested will proceed into the more lucrative Phase 2 clinical trial regime (see across). From Phase 2 to Phase 3, there is a reduced 38% chance of moving forward.

CNS Drug Development Success Rates

	1991-2000	Success	Failure
Phase 1		64%	36%
Phase 2		38%	62%
Phase 3		51%	49%
Registration		72%	28%

Source: Nature Reviews

Dynamics of the CNS Industry: Oligopoly Leads to Clustered End users

Four players in CNS space control 67.3% of the market.

An oligopoly is defined as a market in which the four-firm concentration ratio is above 40%. The four major players in the global CNS market are GlaxoSmithKline (GSK), Johnson and Johnson (J&J), Eli Lilly and Pfizer, who collectively control 67.3% of the global (US\$63 billion) CNS market. Other global pharmaceutical companies with a substantial CNS portfolio of drugs includes Merck, AstraZeneca, Abbott, Sanofi Aventis, Novartis, Roche and Wyeth.

CNS portfolios for major pharma's look robust.

The product pipelines of the various pharma companies in the CNS area are highlighted across. In some cases product pipelines were not forthcoming. We understand CogState has conducted work for Alza Corporation (part of J&J), Organon USA and the CDC – aside from Pfizer. We believe there remains a significant business development opportunity for CogState in the near term as a result of this analysis.

Major Pharmaceutical Companies - CNS Portfolios 2005

Company	Pre-Clinical	Phase 1	Phase 2	Phase 3
Pfizer	n/a	n/a	n/a	4
J&J	n/a	n/a	n/a	5
GSK	n/a	14	10	5
Novartis	n/a	n/a	-3	-3
Eli Lilly	n/a	n/a	n/a	0
Abbott	n/a	n/a	-4	n/a
AstraZeneca	7	1	1	4
Sanofi Aventis	11	4	6	5
Wyeth	n/a	n/a	2	2
Roche	4	2	0	0
Merck	3	5	3	1

Source: Companies

CogHealth, CogSport, Alert 4 Work and Sentinel

CogHealth is a set of tests designed to be used as part of annual check ups in patients over the age of 50 to detect mild cognitive impairment (MCI), which is associated with early onset Alzheimer's Disease. Sales of the product are niche, with FY05 sales of \$41,117 up 91% pcp. Alert 4 Work is a new testing regime which is scientifically validated to see whether or not a worker is impaired. The impairment may be the result of alcohol, fatigue or drugs.

CogSport and Concussion Sentinel essentially target the same market, which is neuropsychological testing of concussed athletes. There have been 27 publications to date on the use of CogSport/Sentinel. Cognitive testing using CogSport is designed to supplement evaluation of the clinical signs and symptoms typically observed after concussion. Unlike some other neuropsychological tests, CogSport cannot be faked. CogSport tests are sold for \$40 per test. Concussion Sentinel is engineered for use in the US. CogState has partnered with Schutt Sports, the largest manufacturer of US football helmets, which will see CogState charge a fee for cognitive services provided. FY05 sales of \$144,655 were down 5.4% pcp.

Other R&D and Licensing Initiatives

To strengthen its current battery of cognition tests, CogState has embarked on new collaborative R&D projects and in-licensing initiatives, which are discussed below. The net effect of such initiatives is to allow for the development of new innovative products that can be essentially bolted on to the existing product offering.

Strengthened Product Offering with Pfizer's Cognition Test

In 2004, CogState has also entered into an agreement to market a cognitive test developed by Pfizer, to enable the wide usage of the test in clinical trials worldwide. The Groton Maze Learning Test (GMLT) was developed by Pfizer to be used in clinical programs to test the "executive function" or the ability to solve problems and reason. It is therefore applicable to most CNS trials, but particularly in trials for drugs used in schizophrenia and ADHD. Pfizer's Groton Maze Learning Test is an excellent complement to the CogState suite of cognitive tests which are being used by pharmaceutical companies in clinical studies, as well as in clinical practice.

Licensed Pfizer test.

Acquired Voice Analysis Software

CogState has also signed an agreement with a Canadian based company to acquire a Voice Analysis (VA) software product which can identify symptoms of Parkinson's Disease. The Company believes the software may also have applications in clinical settings for identifying and assessing treatment response in Parkinson's Disease, Schizophrenia and other disorders of the brain. The acquisition was for CogState scrip (200,000) and further milestones in cash and equity will be forthcoming should the VA test meet CogState's expectations.

Acquisition of VA software to complement product offering.

A\$1.28 million Pfizer Product Development Deal

In December 2005, CogState signed an A\$1.28 million non-dilutive funding deal with Pfizer over three years to accelerate the development of its cognitive test portfolio. Specifically, the funding will be used for:

A\$1.28 million in Pfizer funding.

1. the development of a set of novel paediatric neuropsychological computer tests;
2. the development of a technology for modelling brain function using analysis of the acoustic properties of human speech (as described above); and
3. the on-going development of CogState's proprietary technology for the early detection of dementia due to Alzheimer's disease.

The paediatric cognitive tests will be designed specifically for the neuropsychological assessment of children in clinical trial settings. For any new medicine designed for use by children, across most therapeutic areas, it is important to ensure that new therapies will not interfere with a child's cognition and school performance.

Emerging Functional Food Testing Market

Functional food trials remain an untapped market segment for CogState.

Functional Foods are foods or dietary components that may provide a health benefit beyond basic nutrition. Although typically the size of a drug development Phase 1 clinical trial, the nutraceutical testing market can be considered an opportunity for CogState. The Company has already successfully conducted cognition trials with several food companies to determine whether certain food groups have a net benefit on brain function (cognition). One study involved one of the largest chocolate manufacturers in the world, based in Belgium.

Recently, the Company announced it had struck a \$400,000 clinical trial deal (net \$220,000 to the bottom line) with an undisclosed European food products company over the next 12-15 months. As discussed below, we believe there are several key drivers in the functional food market that could lead to further contracts for CogState with other food majors.

Regulatory frameworks will drive cognition testing to make health claims.

Market Research believes the current global functional foods market is US\$7-63 billion. The global functional foods market is expected to grow to US\$167 billion by 2010. The functional foods product category is expected to continue to grow strongly through 2006, and taper off by 2010 as the market matures. The global growth rate for functional foods will likely achieve an average of up to 14% annually through 2010.

There are several key drivers for this testing market, which we believe will show strong growth prospects over the coming years. Both the US Food and Drug Administration (FDA) and the Australian TGA have indicated that health claims must be substantiated with scientific evidence to support the claim. For example, the FDA regulations require a rigorous approval process for health claims. Marketers are not required to get agency approval for claims that talk about the body's "normal, healthy structures and functions," only for references to specific diseases or health conditions. In the European Union, the Confederation of Food and Drink Industries has issued a voluntary code for companies seeking to make a health claim. Claims that a foodstuff may help to prevent, treat or cure a human disease (e.g. reduction of disease risk claim) are currently prohibited in EU food law.

Foods with a positive effect on cognition are deemed important.

Consumer interest in the relationship between diet and health has increased the demand for information on functional foods. Rapid advances in science and technology, increasing healthcare costs, changes in food laws affecting label and product claims, an aging population, and rising interest in attaining wellness through diet are among the factors fuelling interest in functional foods. In short, food companies are looking for key differentiators in their product offerings, such as the ability to make a health benefit claim.

We believe there is an opportunity for CogState in providing cognition testing services to ascertain whether certain food groups have a net positive cognitive effect. Indeed, Sloan Trends and Solutions have found that 29% of US men and 36% of women are very concerned about mental acuity, mental cognition and its effect on performance. Mood and cognition benefits are also driving the development of functional foods able to make this claim (see across). Recently, confectionery giant M&M Mars repositioned its "Mars" bar in Europe, based on studies in The Netherlands and the U.K., claiming it improves mental cognition and reduces stress. In addition, a number of epidemiological studies in Europe are pointing to the key role of the A, C, E antioxidants in mental cognition.

Very Influential	%
Heart disease	49
Cancer	37
Osteoporosis	27
Gut Health	21
Obesity	37
Immune system	17
Bowel function	11
Arthritis	3
Mood/cognitive perform	7
Neural tube defects	8
Urinary tract infections	0

Source: Sloan Trends and Solutions

Examining the Competitive Landscape

Highly competitive space.

CogState does operate in a highly competitive overall cognition testing market. Numerous companies in the market offer a battery of cognitive tests for a range of disorders. In our discussions with CogState management, they believe the Company is well positioned to capture an increasing share of the clinical trials market. We believe this is due to a

Competitors may not be maximising the clinical trial market.

combination of a testing battery well suited to this market, a lack of focus and business development from competitors in this market and leveraging off the validation provided by Pfizer's use of ClinIT.

Main competitor is the old "pencil and paper" test.

Interestingly, perhaps the greatest competition comes from the continued use of antiquated "pencil and paper" tests. However, a significant percentage of companies developing new CNS drugs seek to utilise well established testing regimes that regulatory bodies like the FDA are comfortable with. We do believe the growth in use of computerised testing batteries is changing this landscape. We have highlighted four competitors with computer based cognitive testing below.

The Brain Resource Company

The Brain Resource Company (BRC) is an ASX listed healthcare company that provides a comprehensive methodology to assess brain and body function. BRC has set up the world's first standardised international database. Overall, the Company provides personal and medical history, electrical brain function, brain structure and genetic testing.

BRC does offer cognition testing as part of its overall business model to the clinical trials market. IntegNeuro™ is an easy to use, fully automated series of tests that reflect an individualised Cognitive Performance Profile, drawing on the Brain Resource International Database. However, unlike CogState's test battery, BRC has a total of twelve tasks which will take approximately 50 minutes to complete. This could make the test battery less attractive in clinical trials. We believe BRC provides a very useful ASX comparable in a similar technology space and as such have compared BRC with CogState (across). On this basis CogState appears undervalued by the market.

	CogState (CGS)	Brain Resource (BRC)
Market Cap. (A\$m)	3.9	33.3
Cash (31/12/05)	2.30	5.10
FY04 Sales (A\$m)	0.19	0.50
Growth (%)	5.0%	105.0%
FY05 Sales (A\$m)	1.03	1.20
Growth (%)	439.5%	145.0%
Est. FY06 Sales (A\$m)	1.8	1.5
Growth (%)	75.1%	25.0%

Source: Company

CogState appears undervalued compared to BRC.

Cambridge Cognition

Cambridge Cognition is a privately held company that specialises in computerised neuropsychological testing, based in Cambridge, England. Cambridge supplies its products and services to pharmaceutical, academic and healthcare customers across the globe. The Company has a long standing relationship with GlaxoSmithKline. We believe 2003 sales were around A\$3 million, with 26 employees.

Cognitive Drug Research (CDR)

Arguably one of the oldest computer-based cognition testing businesses. The CDR system has been developed to assess both enhancement and impairment of human cognition in a clinical trial setting. This is not dissimilar to CogState's own battery, though we note CDR's battery has been utilised in over 500 clinical trials worldwide (compared with 21 for CogState). This gives the test significant validation, and in our view represents a barrier to entry for competitors such as CogState. We believe 2003 sales were approximately A\$5.5 million. The Company notes 47 employees on its website.

CogTest

The CogTest console is a precision cognitive assessment tool for Phase 1 to Phase 4 clinical trials. The Company is based in the UK, with operations abroad and provides cognitive testing and data capture services for clinical trials programmes on new or existing compounds and applications. Past clients of the Company include: AstraZeneca Pharmaceuticals LP, GlaxoSmithKline, Novartis Pharmaceuticals Pfizer Global Research and Development and Wyeth. The Company was declared bankrupt in 2005, which we believe to be in part a management issue, rather than a failure of the technology platform.

Risks

Cash burn is minimal.

An investment in CogState is not without risk. However, unlike other biotechnology companies, CogState is generating real revenues to offset cash burn. In essence, post-drug development divestiture, CogState is ostensibly a healthcare service provider. Our modelling indicates that CogState will generate positive free cash flows in FY07. Therefore we see the downside risk to cash as being manageable at present.

The bulk of revenues are derived from Pfizer, which is a key risk.

The key risk for CogState remains its reliance on Pfizer for the bulk of its ClinIT product revenues and therefore overall sales. We believe the ability of CogState to grow product revenues depends on a large extent to maintaining the Pfizer relationship, while diversifying its revenue sources by acquiring new business from other pharmaceutical companies. We have seen evidence of this through contracts with other large global players. As mentioned, a second benefit the Pfizer relationship brings to CogState is validation of its testing platform. Therefore, any termination of the Pfizer deal could be viewed negatively in the industry, making new deal flow at best difficult, resulting in a significant downgrade to our revenue estimates and valuation.

Retaining key scientific expertise is essential.

We believe a further risk to be retaining key staff, particularly the scientific founders/consultants utilised by the Company. This encompasses Professor Paul Maruff, Professor Peter Snyder, A/Professor David Darby and Dr Alex Collie who are critical in gaining new end users, but also in the interpretation, compilation and presentation of the data to clients. In short, such expertise is difficult to replace. The strength of the quarter on quarter organic sales growth for (predominately) ClinIT also indicates CogState will require additional expert personnel moving forward in order to manage this growth effectively. There is a risk that such personnel are difficult to recruit into the Company, particularly given the market value at present.

Impressive 1H06 Results

1H06 result indicates business strategy taking shape.

CogState recently announced a set of impressive 1H06 numbers, which provides further evidence that the restructured business plan announced in September is beginning to bear fruit. The strategy of focusing predominately on the clinical trial testing market has provided evidence of product revenue growth, reduced expenditure in key areas, a reduction in cash burn and improvements in NPAT losses.

1H06 product sales up 55.3% pcp.

1H06 product sales were up 55.3% pcp, largely driven by the provision of cognitive testing services within the clinical trial setting. NPAT loss for the period was down 11.6% to \$1.27 million. Total operating expenses of \$2.5 million were up 15.5% pcp. Employee salaries and benefits comprised 64.6% of total operating expenditure. Employee expenses are expected to decrease as a result of cessation in drug development and a re-alignment of business activities to the US and Europe for clinical trials.

NPAT loss down 11.6% to \$1.27 million.

Contracted future revenues of \$2.0 million.

We also note approximately \$2.0 million in contracted future revenues that will be progressively brought to account in FY06 (\$0.8 million) and FY07 (\$0.7 million).

DCF Valuation

DCF valuation based on further penetration into clinical trials market.

Our discounted cash flow (DCF) valuation is predicated on the inputs/assumptions as shown across. We have assumed the bulk (+ 95%) of CogState future revenues to FY11 are derived from clinical trials, with the Company achieving a modest 6.4% market share or 1% penetration per annum from FY07-FY11. We expect the CNS clinical trial testing market to show 4.05% CAGR over the same period.

CAPM Assumptions	
Risk Free Rate	5.5%
Market Risk Premium	7.8%
Market Return	13.3%
Est Beta	1.80
CAPM Discount Rate	19.5%
Terminal Growth Rate	0.0%

Source: Taylor Collison

Value of A\$15.6 million or \$0.35 per share (fully diluted).

Our modelling indicates that CogState has a present value of A\$12.9 million or A\$15.6 million including pro-forma cash, equating to a fully diluted per share value of \$0.35 (see below). The value ascribed to CogState still places the Company at a significant discount to its ASX listed peer Brain Resource Company (ASX:BRC).

CogState NPV Calculation	FY06	FY07	FY08	FY09	FY10	FY11
(\$ '000)	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
EBITDA	(2,222)	(173)	503	1,802	3,561	5,522
Depreciation & Amortisation	51	77	118	136	143	146
Net Interest	139	69	79	152	381	660
Tax	347	332	0	0	(1,068)	(1,657)
Change in NWC	(6)	(108)	(82)	(102)	(112)	(122)
Free CFs	(1,690)	196	619	1,987	2,904	4,549
Terminal Value						23,279
PV of CFs	(1,690)	164	433	1,163	1,422	11,400
Total NPV	12,893					
Pro-forma cash	2,800					
Implied DCF Value	\$0.35					
DCF (fully diluted)*	\$0.35					

* Assumes none of the 9.5 million options on issue are exercised; Source: Taylor Collison estimates

Summary

CogState represents a viable turnaround story.

Small market size, but growing.

\$0.35 price target.

We believe CogState represents a valid turnaround story, and we expect a market re-rating on the back of continued significant revenue growth through key product sales in the clinical trial testing market and profitability in FY07. While the Company operates in a market we value at US\$90 million, it is important to note the overall market size is trending upwards and CogState has penetrated only 0.7% of it. Further upside exists in the expanding functional food testing market, as food companies seek to justify the health benefits of selected food groups through scientific testing and product claims.

We are forecasting an FY06 NPAT loss of \$1.8 million, down 21.7% pcp on total revenues of \$2.5 million, up 66.4% pcp. We expect the Company to turn a maiden profit in FY07 of \$0.15 million. Our DCF analysis values the Company at \$15.6 million, or \$0.35 per share (fully diluted), which is a significant premium to the current price. We believe CogState remains undervalued and therefore initiate research coverage with a Speculative Buy recommendation and a price target of \$0.35.

CGS - Summary of Forecasts

CGS \$ 0.10

PROFIT & LOSS SUMMARY (A\$000s)						
Period	FY04A	1H05A	FY05A	1H06A	FY06E	FY07E
Total Revenue	385	710	1,525	985	2,538	4,322
<i>Growth (pcp)</i>	<i>n/a</i>	<i>0.0%</i>	<i>296.1%</i>	<i>38.7%</i>	<i>66.4%</i>	<i>70.3%</i>
Net Operating Revenue	(2,187)	(1,231)	(2,302)	(1,360)	(1,808)	185
Direct R&D Expenses	(41)	(147)	(260)	(210)	(275)	(289)
EBITD	(2,098)	(1,509)	(2,783)	(1,641)	(2,222)	(173)
Dep'n/Other Amort'n	(28)	(19)	(51)	(31)	(51)	(58)
EBIT	(2,189)	(1,559)	(2,897)	(1,672)	(2,273)	(250)
Net Interest	(130)	131	221	71	139	70
Pre-Tax Profit	(2,319)	(1,428)	(2,676)	(1,601)	(2,134)	(180)
Tax Expense	485	(6)	397	348	348	332
Minorities	0	0	0	0	0	0
NPAT	(2,678)	(1,434)	(2,279)	(1,253)	(1,786)	152
<i>Growth (pcp)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>
Net Abnormals	0	0	0	0	0	0
Reported Profit	(2,678)	(1,434)	(2,279)	(1,253)	(1,786)	152
NPAT pre Net R&D	(1,849)	(1,333)	(2,308)	(1,129)	(1,597)	440

PER SHARE DATA						
Period	FY04A	1H05A	FY05A	1H06A	FY06E	FY07E
Reported EPS (c)	(9.4)	(4.0)	(6.4)	(3.5)	(4.5)	0.3
<i>Growth (pcp)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>
EPS Pre-Net R&D (c)	(9.5)	(3.7)	(6.5)	(0.0)	(4.1)	1.0
<i>Growth (pcp)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>
Dividend (c)	0.0	0.0	0.0	0.0	0.0	0.0
Franking	0%	100%	0%	0%	0%	0%
Gross CF per Share (c)	(9.7)	(4.3)	(5.9)	(4.2)	(4.4)	0.7
NTA per share (c)	41.0	12.1	9.7	7.5	3.2	2.8

KEY RATIOS						
Period	FY04A	1H05A	FY05A	1H06A	FY06E	FY07E
EBITD/Sales Margin %	-544.9%	0.0%	-182.5%	-166.6%	-87.5%	-4.0%
EBIT/Sales Margin %	-568.6%	0.0%	-190.0%	-169.7%	-89.6%	-5.8%
Current ratio (x)	25.7	12.1	6.9	3.4	2.2	1.6
Net Debt : Equity (%)	-5.3%	-6.7%	-29.2%	-74.5%	-76.0%	-89.3%
ROE (%)	n/a	n/a	-46.0%	0.0%	-64.9%	9.1%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

VALUATION MULTIPLES						
Period	FY04A	1H05A	FY05A	1H06A	FY06E	FY07E
PE Ratio (x)	n/a	n/a	n/a	n/a	n/a	29.3
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
EV/EBITD (x)	n/a	n/a	n/a	n/a	n/a	(17.2)
EV/EBIT (x)	n/a	n/a	n/a	n/a	n/a	(11.9)

CAPITAL RAISING ASSUMPTIONS						
Period	FY04A	1H05A	FY05A	1H06A	FY06E	FY07E
Shares Issued (m)	19.5	0.0	0.0	3.0	8.6	0.0
Issue Price (A\$)	0.5	0.00	0.00	0.10	0.10	0.00
Cash Raised (A\$m)	9.75	0.0	0.0	0.3	0.86	0.0

BALANCE SHEET SUMMARY						
Period	FY04A	1H05A	FY05A	1H06A	FY06E	FY07E
Cash	321	318	1,119	2,278	1,272	1,472
Receivables	122	531	344	1,122	628	1,258
Inventories	0	0	0	0	0	0
Investments	5,250	3,582	2,311	0	0	0
Other	46	83	47	28	28	0
Total Current Assets	5,739	4,514	3,821	3,428	1,928	2,731
Investments	0	0	0	0	0	0
Inventories	0	0	0	0	0	0
Property Plant & Equip	66	152	139	165	165	270
Intangibles	438	407	375	402	400	380
Deferred Tax Assets	34	28	55	37	38	38
Other	34	0	0	30	31	0
Total Non-Current Assets	572	587	569	634	634	688
TOTAL ASSETS	6,311	5,101	4,390	4,062	2,562	3,418
Accounts Payable	130	287	397	886	700	1,402
Borrowings	0	0	0	0	0	0
Provisions	93	87	155	110	180	359
Total Current Liab	223	374	552	996	880	1,762
Borrowings	0	0	0	0	0	3
Provisions	0	0	8	8	8	8
Other	0	0	0	0	0	0
Total Non-Current Liab	0	0	8	8	8	11
TOTAL LIABILITIES	223	374	560	1,004	888	1,773
TOTAL EQUITY	6,088	4,727	3,830	3,058	1,674	1,646

CASH FLOW SUMMARY						
Period	FY04A	1H05A	FY05A	1H06A	FY06E	FY07E
EBIT (excl Abs/Extr)	(2,189)	(1,559)	(2,897)	(1,672)	(2,273)	(250)
Add: Depreciation	28	19	51	31	51	58
Change in Pay.	(150)	(150)	267	489	303	702
Less: Tax paid	485	(6)	397	348	348	332
Net Interest	(130)	131	221	71	139	70
Change in Rec.	(3)	(3)	(222)	(778)	(284)	(630)
Change in Inv.	0	0	0	0	0	0
Gross Cashflows	(1,896)	(1,537)	(2,120)	(1,511)	(1,716)	301
Capex	(55)	(105)	(124)	(55)	(100)	(100)
Free Cashflows	(1,951)	(1,642)	(2,244)	(1,566)	(1,816)	201
Dividends Paid	0	0	0	0	0	0
Net Cash Flow	(1,951)	(1,642)	(2,244)	(1,566)	(1,816)	201

Disclaimer

Taylor Collison Limited ("Taylor Collison") may from time to time provide corporate advice or other services for, or solicit business from CogState Limited ("CogState"). For CogState's securities, Taylor Collison may make a market and may sell or buy on a principal basis. In December 2005, Taylor Collison was appointed the sole broker to place 3,000,000 new shares at \$0.10 per share. Taylor Collison received a fee of 5% and 1 million unlisted options exercisable at \$0.17 on or before 15 December 2007. In February 2006, Taylor Collison was appointed sole underwriter to a non-renounceable rights issue to raise \$556,055 at \$0.10 per share. Taylor Collison will receive an underwriting fee of 5% and 1 million unlisted options. Taylor Collison directors and staff hold shares in CogState.

This report is a private communication to clients and intending clients and is not intended for public circulation or publication or for the use of any third party, without the approval of Taylor Collison. While the report is based on information from sources that Taylor Collison considers reliable, its accuracy and completeness cannot be guaranteed. This report does not take into account specific investment needs or other considerations, which may be pertinent to individual investors, and for this reason clients should contact Taylor Collison to discuss their individual needs before acting on this report. Those acting upon such information and recommendations without contacting one of our advisors do so entirely at their own risk.

Taylor Collison Limited **Sharebrokers and Investment Advisers**

A.B.N. 53 008 172 450
AFSL No. 247083

Participant of the Australian Stock Exchange Group

Level 2, 12 Pirie Street
Adelaide, South Australia, 5000
G.P.O. Box 2046, Adelaide, South Australia, 5001
Telephone: 08 8217 3900 Facsimile: 08 8231 3506
Email: broker@taylorcollison.com.au

Level 2, 55 Hunter Street
Sydney, New South Wales, 2000
G.P.O. Box 4261, Sydney, New South Wales, 2001
Telephone: 02 9232 1688 Facsimile: 02 9232 1677
Email: sydney1@taylorcollison.com.au

www.taylorcollison.com.au

ESTABLISHED 1928