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Industry: Personalized Medicine
Company Update

February 10, 2012
BUY

GENETIC TECHNOLOGIES, LTD. (NASDAQ: GENE)

1H12 Earnings Preview; Expect BREVAGen to Continue Tracking In Line with Expectations; Trimming 1H12 Forecast to Account for Timing of Licensing Payments

INVESTMENT RATING	**BUY**
Prior rating	
Price Target	US$7.50
Prior Target	
Price (2/9/12)	$4.10
52 Week Range($US)	$1.50 -$10.75
Shares Outstanding (ADR)	13.5 MM
Market Cap. ($US)	$65.6 MM
Cash (12/31/11)	$12.6 MM
FISCAL YEAR END	**June**

REVENUE (MM'S):

	Current	Prior
2013E	$21.2	
2012E	$12.5	$15.0
2011A	$18.3	

EPS (F.D.):

	Current	Prior	P/E
2013E	$0.08		NA
2012E	($0.23)	($0.11)	NA
2011A	$0.07		NA

EPS in Australian dollars
On 2/8/12, exchange rate was USD$1.00:AUD$0.92

BI-ANNUAL EPS:

	Current	Prior
2013E		
Dec	$0.01	
Jun	$0.06	
2012E		
Dec	($0.22)	($0.11)
Jun	($0.01)	

Note: Quarterly 2013 EPS figures do not sum Annual 2013 figure due to rounding.

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HIGHLIGHTS

Following the release preliminary 4C quarterly filings with the Australian Stock Exchange (ASX) earlier this week, we are trimming our fiscal 1H12 and full year licensing revenue by $2.5M to $1.5M and $7.5M, respectively, due to timing of IP settlements under the company's 3rd assertion program, resulting in a reduction in 1H12 EPS from ($0.11) to ($0.22) and full year 2012 from ($0.11) to ($0.23). However, we remain upbeat about the near term prospects for new license agreements as several of the patent assertion cases have entered discovery and we are reiterating our forecast of $6M of revenue from patent settlements in 2H12. We expect BREVAGen to record relatively modest test volumes in its first six months of launch and encourage investors to look to 2H12 for a more accurate assessment of product's launch trajectory. Our investment thesis calls for GENE to redeploy the potential windfall from its patent licensing program into the acquisition and revalidation of 1 to 2 new tests per year. While the timing of business development is always uncertain, we expect management to remain active in the pursuit of additional products, particularly for the U.S. market. Reiterate Buy rating and $7.50 target price.

- **BREVAGen Launch Still in Early Days – Estimate of 309 tests for 1H12:** Like most molecular diagnostics, we expect uptake of BREVAGen in the United States to be modest until reimbursement processes are formalized. Our 1H12 estimate calls for delivery of 309 tests at a net price to GENE of US$410 per test, which translates to reported revenues of $0.1M. We expect test volumes to ramp up in 2H12 as GENE wins additional insurance coverage. Our full year estimate is unchanged at 1,932 tests.

- **IP Settlement with Eurofins:** Earlier this week GENE announced an IP settlement with Eurofins STA Laboratories, Inc. We'd note Eurofins substantially larger operations in Europe are not covered by this license and believe the European parent company may be a source of future license discussions. This is the 3rd settlement agreement among the 10 companies GENE filed suit against in U.S. District Court for the District of Colorado on May 26, 2011. We believe many of 7 remaining cases have moved into discovery, which requires counterparties to make significant commitments of time and capital. As such, we expect the pace of settlement discussions to accelerate. Based on timelines from 2 earlier assertion processes, we believe half of the remaining cases may be settled in the next six months and a 4th assertion filed by yearend.

- **Structure of ASX Quarterly Filings and 2Q12 Disclosures:** We'd note that while share for Genetic Technologies trade as ADRs on NASDAQ and primary share on the ASX, the company's financials are disclosed only in accordance with ASX format, which includes detailed filings every six months and quarterly filings consisting primarily of a consolidated cash flow. The company's quarterly filing this week disclosed cash flow from operations of ($3.5M) for the six months ending Dec. 31 and an ending cash balance of $12.6M. The company expects to file a midyear update for the first six months of fiscal 2012 (including an income statement and detailed operating metrics) by the end of February.

All $ in Australian Dollars unless noted; U.S. Dollar notation (US$)

Table 1.

Genetic Technologies Income Statement										
(in $ millions except per share)	**2011A**	**1H12E**	**2H12E**	**2012E**	**1H13E**	**2H13E**	**2013E**	**1H14E**	**2H14E**	**2014E**
BrevaGen sales	$0.0	$0.1	$0.3	$0.4	$1.2	$2.0	$3.2	$3.5	$5.2	$8.7
Genetic Testing Services	4.6	2.4	2.2	4.6	2.4	2.2	4.6	2.4	2.2	4.6
License Fees and Other Revenue	13.7	1.5	6.0	7.5	6.4	7.0	13.4	8.6	9.2	17.8
Total Revenue	$18.3	$4.0	$8.5	$12.5	$10.0	$11.1	$21.2	$14.4	$16.6	$31.0
COGS	6.1	1.5	2.9	4.4	3.4	3.7	7.0	4.7	5.3	10.0
Gross profit	$12.1	$2.4	$5.6	$8.1	$6.6	$7.5	$14.1	$9.7	$11.3	$21.0
G&A	3.8	1.9	1.7	3.6	1.8	1.6	3.4	1.7	1.5	3.2
Research & development	4.4	2.2	2.0	4.2	2.0	2.0	4.0	2.0	2.0	4.0
Sales and Marketing	3.0	1.8	2.2	4.0	2.6	2.9	5.5	3.1	2.9	6.0
Operating profit (loss)	$1.0	($3.5)	($0.2)	($3.8)	$0.2	$1.0	$1.2	$3.0	$4.8	$7.8
Interest income (expense)	0.2	0.1	0.0	0.2	0.0	0.0	0.0	0.1	0.1	0.1
Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.9	1.5	2.4
Net profit (loss)	1.2	(3.4)	(0.2)	(3.6)	0.2	1.0	1.2	2.1	3.4	5.5
Earnings (loss) per share	$0.09	($0.22)	($0.01)	($0.23)	$0.01	$0.06	$0.08	$0.14	$0.22	$0.36
Profit (loss) from Discontinued Operations	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Net income (loss) as reported	0.9	(3.4)	(0.2)	(3.6)	0.2	1.0	1.2	2.1	3.4	5.5
Profit (loss) per share as reported	$0.07	($0.22)	($0.01)	($0.23)	$0.01	$0.06	$0.08	$0.14	$0.22	$0.36
Weighted average common shares (ADR)	13.5	15.5	15.5	15.5	15.5	15.5	15.5	15.5	15.5	15.5
Margin Analysis										
Gross Margin	66.4%	60.9%	66.1%	64.5%	66.4%	67.0%	66.7%	67.5%	68.0%	67.8%
Operating Margin	5.3%	-89.0%	-2.8%	-30.1%	2.1%	8.9%	5.7%	20.5%	29.2%	25.1%
Net Margin	0.5%	-5.5%	-0.2%	-1.9%	0.1%	0.6%	0.4%	0.9%	1.3%	1.2%

Source: Company reports and Ladenburg Thalmann estimates

Note: Quarterly 2013 EPS figures do not sum to Annual 2013 EPS figure due to rounding.

Table 2.

Expected Near-term Events		
Event	**Time (Fiscal Year)**	**Importance**
In-licensing of 2nd oncology diagnostic test for U.S. market	2H12	High
Filing of 4th round of patent assertion claims	2H12	Medium
Validation data from expanded BREVAGen SNP panel	2H12	High
Validation of BREVAGen in Hispanic population	2H12	High
Publication of BREVAGen pharmacoeconomic study	1H13	Low
Launch of 2nd diagnostic in the U.S.	1H13	Medium
Filing of 5th round of patent assertion claims	1H13	Medium
In-licensing of 3rd oncology diagnostic test for U.S. market	2H13	High

Source: Ladenburg Thalmann estimates

APPENDIX A: IMPORTANT RESEARCH DISCLOSURES

ANALYST CERTIFICATION

I, Kevin DeGeeter, attest that the views expressed in this research report accurately reflect my personal views about the subject security and issuer. Furthermore, no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation or views expressed in this research report.

The research analyst(s) primarily responsible for the preparation of this research report have received compensation based upon various factors, including the firm's total revenues, a portion of which is generated by investment banking activities.

COMPANY BACKGROUND

Genetic Technologies is a genetic testing laboratory based in Melbourne, Australia with operations in Australia, Southeast Asia and the U.S. In June 2011, GENE launched BREVAGen in the U.S. for assessing a woman's risk of developing breast cancer based on clinical characteristics and analysis of a panel of somatic mutations. The Australian operations provide genetic testing for cancer risk assessment, paternity and forensics. The company also derives significant revenue from licensing of patents and other intellectual property pertaining to the role of non-coding DNA and related applications for diagnostic testing.

VALUATION METHODOLOGY

We currently rate GENE shares at BUY with a price target of $7.50 based on 25x multiple on 2014 earnings per ADR of $0.36 discounted back at a 20% cost of capital.

RISKS

We think the primary risks of an investment in GENE shares include, but are not limited to: Competition: While BREVAGen faces limited direct competition, adoption of the product may be impacted by general acceptance of Gail score compared to other clinical measures for breast cancer risk and by the general availability and cost of SNP testing. In certain academic oncology settings BREVAGen may compete with internally developed risk assessment tools. Additionally, the Australian operations face competition from private and public laboratories. There can be no assurance the performance differences between BREVAGen and other tests will offer a sustainable competitive advantage. Regulatory: GENE is subject to clinical laboratory regulations by regulators in both Australia and the United States under the auspicious of the National Association of Testing Authority (NATA), and CLIA, respectively. Additionally, the company may eventually seek FDA 510(k) or PMA clearance for BREVAGen. There can be no assurance validation studies and subsequent registration studies will be adequate to support PMA or 510(k) clearance of BREVAGen as a screening test for somatic genetic risk of breast cancer. Additionally, there can be no assurance the intended use claim for an expanded SNP panel for BREVAGen will offer clinically important differentiation from the 7-SNP first generation BREVAGen test. Reimbursement: There are no specific treatment guidelines recommending tests such as BREVAGen that combine clinical risk assessment and genetic analysis, and limited payer experience interpreting the clinical utility of combining clinical and genetic measures of risk into a single test for risk assessment. We expect initial reimbursement to be based primarily on CPT code stacking for the set number of SNPs in BREVAGen. While early experience suggests payers will reimburse for BREVAGen based on code stacking, there can be no assurance of broad coverage based on this methodology or that future changes to the application of code stacking will not adversely impact BREVAGen reimbursement rates. Currency: The functional and reporting currency for GENE is the Australian dollar. However, an increasing portion of the company's operating expenses and a small but growing portion of revenues are denominated in U.S. dollars. Additionally, the company maintains active and liquid public stock listings on both the Australian Stock Exchange and NASDAQ. While the exchange rate of the Australian dollar to U.S. dollar has historically been relatively stable, there can be no assurance future volatility in currency exchange rates will not materially impact the cost of funding the company's U.S. operations or impact the price movement of common shares trading on the Australian Stock Exchange or ADRs trading on NASDAQ. SEC reporting requirements may differ slightly from U.S. based entities and investors may not be afforded the same protection or information as a U.S. based entity. Additionally, trading volume has been historically low which could impact an investor's investment. Supply Chain: GENE ships BREVAGen samples from the United States to its laboratory in Australia for analysis and expects to maintain a similar supply chain for any new tests launched in the United States, at least over the near term. There can be no assurance disruptions to international air travel or changes to trade regulations between Australia and the United States will not adversely impact the company's relationships with clinicians or GENE's strategy for expanding its molecular diagnostic business in the United States. Financing: The company believes its financial resources will fund operations through at least 2012. However, depending on the pace of BREVAGen adoption and capital requirements to expand the oncology products portfolio through internal development or acquisition, GENE may need additional capital to fund U.S. expansion. There can be no assurance GENE will have access to private capital in the future on adequate terms, or at all. Intellectual Property: GENE relies on license agreements related to issued patents for a majority of its revenue. Additionally, the company has several pending method patent applications pertaining to BREVAGen. There can be no assurance changes to U.S. patent law or interpretation will not adversely impact the company's future revenues.

STOCK RATING DEFINITIONS

Buy: The stock's return is expected to exceed 12.5% over the next twelve months.
Neutral: The stock's return is expected to be plus or minus 12.5% over the next twelve months.
Sell: The stock's return is expected to be negative 12.5% or more over the next twelve months.

Investment Ratings are determined by the ranges described above at the time of initiation of coverage, a change in risk, or a change in target price. At other times, the expected returns may fall outside of these ranges because of price movement and/or volatility. Such interim deviations from specified ranges will be permitted but will become subject to review.

RATINGS DISPERSION AND BANKING RELATIONSHIPS (AS OF 1/31/12)

Buy:	76%	(31% are banking clients)
Neutral:	24%	(10% are banking clients)
Sell:	0%	(0% are banking clients)

PERSONALIZED MEDICINE STOCKS UNDER AUTHOR ANALYST COVERAGE ("The Universe")

BG Medicine (BGMD), Exact Sciences (EXAS), Genetic Technologies (GENE), Genomic Health (GHDX), Myriad Genetics (MYGN), Navidea Biopharmaceuticals (NAVB), NeoGenomics (NGNM), OPKO Health (OPK), Response Genetics (RGDX), Sequenom (SQNM), SeraCare Life Sciences (SRLS) and Vermillion (VRML).

COMPANY SPECIFIC DISCLOSURES

With the exception of Navidea Biopharmaceuticals, Inc. (NAVB) and Opko Health, Inc. (OPK), Ladenburg Thalmann & Co. Inc. makes a market in all of the stocks listed in the Universe. Ladenburg Thalmann & Co. Inc. acted as a co-manager in a securities offering for Opko Health, Inc. (OPK) and acted in an advisory capacity on a private securities transaction for Genetic Technologies, LTD. (GENE) in the last 12 months. Ladenburg Thalmann and Co. received compensation related to investment banking services from Opko Health, Inc. (OPK) and Genetic Technologies, LTD. (GENE) in the last 12 months. Ladenburg Thalmann & Co. Inc. expects to receive or intends to seek compensation for investment banking services during the next 3 months for all companies listed in the Universe. Neither the Analyst, nor members of the Analyst's household own any securities issued by any company in the Universe or other companies mentioned in this report. A member of the Board Of Directors of Sequenom Inc. has an affiliation with members of the Board of Directors of companies in which the Chairman of Ladenburg Thalmann Financial Services Inc, the parent company of Ladenburg Thalmann & Co. Inc. has a beneficial interest. Genomic Health Inc. (GHDX) and Teva Pharmaceuticals Industries (TEVA) have joint distribution interests. The Chairman of Ladenburg Thalmann Financial Services Inc. is also Chairman of Teva. The Chairman of the Board and Controlling shareholder of Ladenburg Thalmann Financial Services Inc., the parent company of Ladenburg Thalmann & Co. Inc. is the Chairman of the Board, CEO and Director and Controlling shareholder of Opko Health Inc. Members of the Board of Directors of OPK have a non-investment banking securities related relationship with Ladenburg Thalmann & Co. Inc.

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