

NBT Equity Research LLC

Sector: Transformative Technology

Vertical Market: Automated

Authentication/Security

Technology Company: Visualant, Inc. VSUL www.visualant.net



VISUALANT

**Initiating Coverage January 20, 2011:
Speculative Buy**

Target Price: \$2.25

Current Share Price: \$0.42

Shares Outstanding:
38.8 million as of 1/20/11

Public Float: 16.4 million as of 1/20/11

Market Cap: \$16.3 million as of 1/19/11

We initiate coverage on Visualant, Inc. (VSUL) as a pure-play on a unique, very low cost, patent pending technology for highly secure and accurate authentication technology across a very wide \$20 billion+ market opportunity.

VSUL's unique business model for a technology licensing firm—consolidating existing security/authentication enterprises—gives the company a clear path to rapidly growing cash flow. This consolidation strategy supports the higher margin but “lumpy” licensing revenue model of most transformative technology companies we follow. We expect it to rapidly build current

enterprise value from 25% margin revenues at what ultimately should become a mostly high margin technology licensing company.

Investment Thesis/Key

Investment Points

Cheap, highly efficient primary and secondary authentication/verification technology is a holy grail in the tech world. Visualant's unique and patent-pending way to “read” materials and liquids for their unique spectral signatures at the molecular/photonic level opens up vast and highly profitable opportunities across a wide range of applications and industries.

Combining the vast applications for VSUL technology with its security/authentication industry consolidation strategy, we see a very rare opportunity for both rapid enterprise value creation and substantial upside from licensing revenues for shareholders.

What Does Visualant Technology Do?

Visualant, Inc., develops low cost, high speed light-based security and quality control solutions for use in homeland security, anti-counterfeiting, forgery/fraud prevention, brand protection and process control applications.

The patent-pending technology uses controlled illumination with specific bands of light to establish a unique spectral signature for both individual and classes of items. When matched against existing databases, these spectral signatures allow precise identification and authentication of any item or substance.

Visualant's proprietary technology analyzes the unseen but unique “spectral signature” or photonic fingerprint/components of color of ANY

object—in an unprecedentedly low cost and easy-to-use form factor. Their system recognizes approximately 700 colors that are NOT visible to the human eye.

More important, this breakthrough optical sensing and data capture technology called Spectral Pattern Matching (SPM) reads at the molecular level. We are aware of no other technology with this capability at field unit prices less than \$10.

Most existing automated authentication technologies—RFID tags, retinal/fingerprint scanning—are significantly more expensive to implement, less accurate, or both.

SPM technology can be miniaturized and is easily integrated into a variety of hand-held or fixed-mount configurations, and can be combined in the same package as a bar-code or biometric scanner.

Visualant's breakthrough spectral sensor technology has the very real potential, in our judgment, to become pervasive in the authentication and automated ID application marketplace.

In a global economy with growing threats to

- **Trade secrets/Access Control**—China and emerging markets espionage
- **Government Secrets/Access Control**—Wiki leaks et al
- **Intellectual Property Theft**—imitation/fake consumer products
- **Drug and Food Counterfeiting/Tampering**—from China and third world markets into G-20 countries
- **Currency/Document Forgery**—rampant in every major country
- **Illicit Substance interdiction**—in every major country

Visualant's highly accurate and amazingly low-cost solution addresses a \$20 billion market opportunity that is growing in cost and damage every single day.

Multiple Sector Application and Licensing Opportunities

Visualant's transformative technology is not only applicable to the large security and authentication marketplace. Visualant's SPM technology is also a powerful diagnostic tool that has applicability to the medical, agricultural, environmental and other markets.

The company just announced its first license focused on exploiting SPM technology for use in environmental diagnostics. We strongly believe that other licenses will follow over time. Indeed, an SPM license in a diagnostic field could provide potential revenues which could dwarf Visualant's significant opportunity in the security and authentication market.

In medical diagnostics, for instance, an SPM-enabled hand held device appears to be capable of "seeing" blood sugar characteristics in the human body and thus able to read blood sugar levels without a blood sample. For 150 million people worldwide with Type 2 diabetes this would be a game changer. For health plans seeking compliance with blood sugar reducing medicines, taking a blood sugar reading and sending it to a database with "one-click" of a \$10 VSUL reader is a game changer and a billion-dollar improvement in care.

This is just one application—we can imagine hundreds of other applications in medical treatment compliance and diagnostics alone.

The Javelin LLC License 2011

VSUL recently licensed their SPM technology with a leading Environmental Technology company Javelin LLC out of Seattle.

According to executives at Javelin, Visualant's SPM technology, with its ability to map color at the photon level both within the humanly visible spectrum as well as in the near infra-red and near ultra-violet ranges, can be used as a diagnostic tool for a host of environmental

applications. These include determining the presence of foreign substances such as oil in water and determining water quality, among many others.

Imagine a \$5 hand held device that can tell someone if the water they are about to consume is healthy or unhealthy to drink. Or if the oil present in their beach sand came from a specific deepwater oil well in Louisiana—yes ALL oil from EVERY well site has a unique spectral signature. Javelin LLC co-founder Peter Purdy stated, “I have worked in the optical solutions field for over twenty years. With the Visualant SPM technology we can differentiate our product for testing at the molecular level due to its very low cost. It is a transformative technology with a broad array of potential applications.” Matthew Creedican, Javelin co-founder, added, “We have been aggressive in pursuing Visualant’s technologies for our testing applications and the extreme competitive advantage SPM brings in size, cost and durability. We are excited about a number of the current environmental applications we currently are working with as well as future iterations of the technology.”

The VSUL Unique Value Proposition

The Javelin license is the first of multiple licensing opportunities for the SPM technology we expect to see in medical and agricultural diagnostics and in other fields.

VSUL’s unique value proposition is its ability to deliver molecular level/photon level readings with a \$5-\$10 device—with very healthy margins. We are aware of NO other technology with such attributes.

In addition, unlike most transformational technology companies we review and research, VSUL’s application is NOT a replacement all-or-nothing technological advance. Mostly it’s

an augmentation or “redundancy” strategy that makes existing protocols work better, faster and cheaper.

This is key to our judgment as to market acceptance—vast improvement for little cost makes for MUCH higher ROI.

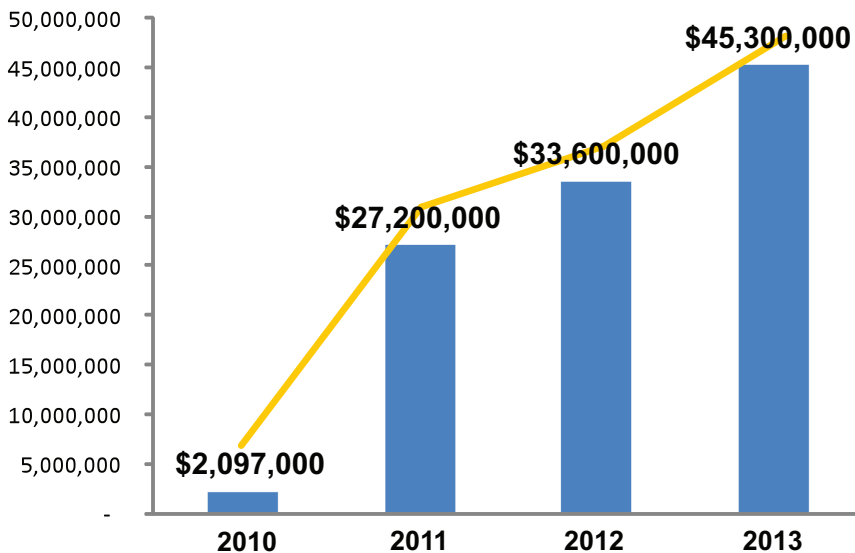
The VSUL Business Model: Ever-Growing Operating Cash Flow & Ever-Growing Licensing Revenues

VSUL has a business model that works NOW. With a plan to acquire vertical market distribution with leading companies—and with their first major acquisition in TransTech Systems, Inc. complete and others lined up—VSUL is among the only cash flow positive emerging technology companies we have ever found.

And VSUL is a very fast growing company—they are on ramp to \$60 million in revenues and gross margins in the 30% range by 2013 (blended for new licensing and existing products).

Summary: Our estimate of enterprise and strategic value of Visualant’s Spectral Pattern Matching technology results in a private market valuation of the company’s forecasted sales and margins at \$2.25 a share (DCF model at 16% percent discount). We assume an additional \$3 million additional equity capital raised during 2011.

Pro-Forma Financial Summary



SOURCE: Visualant Business Plan, 2011

Pro-Forma Financial Summary Assumptions

- The TransTech Systems, Inc. acquisitions closed June, 2010. 10% annual revenue increases are forecast based on new products, territories and additional sales personnel.
- The VSUL SPM product is launched in late 2010/ early 2011 in Japan and the US. The revenue growth is based on new contracts in these and other markets.
- The VSUL license revenue is launched in late 2010/ early 2011 in Japan and the US. The revenue growth is based on new contracts in these and other markets.
- The acquisition forecast is based on a consolidation of security and authentication companies, with 1-2 acquisitions planned for each year during the years 2011-2013.

The Technological Advance: Your Imagination is the Only Limit to the Application

Spectral pattern matching is an ingeniously simple idea.

- Dyes, chemicals and natural pigments all possess a unique spectral signature
 - Invisible to the human eye but...
 - Absolutely unique: like a fingerprint or DNA
- Visualant's technology uses a proprietary micro-miniature camera that illuminates a subject multiple times with changing combinations of colored light
- The unique spectral pattern is detected and compare with unprecedented precision and accuracy

Visualant's technology captures the signature of a wide spectrum of light; color that is visible to humans, but also wavelengths just outside the humanly visible portion of the light spectrum. With Visualant's patent-pending technology, Machines can "see" color that is otherwise invisible; color that is nature's inherent fingerprint. VSUL technology maps color from a surface then enters this spectral map into a proprietary database. This light spectrum snapshot becomes the template for a myriad of applications; from authentication to diagnostics.

Counterfeiters cannot counterfeit what they cannot see

Visualant technology can defeat counterfeiting of everything from currency to documents to pharmaceuticals to branded products of all varieties—by recording the inherent non-visible signature of such items and comparing this signature to a known baseline.

233 Times Stronger Than the Human Eye

Human eyes have 3 color receptors:
red, blue and green

Shrimp have 17 color receptors

Bumblebees have 32 color receptors:
enabling it to see exactly where the nectar is
“hiding” in a plant

Visualant’s technology uses more than 700+ color receptors. This makes the detection of an objects unique/DNA like digital signature possible—and makes thousands of applications possible.

The Visualant Solution

In its essence, Visualant’s patent-pending technology provides spectrum-based pattern file creation and matching. Patterns of a light spectrum signature, from near ultraviolet through the visible spectrum and into the near infrared, are collected from proprietary sensing devices. These pattern files can be created from any material or object. Such pattern files are then matched against baseline pattern files in the Visualant database. Thus, the Visualant technology can serve as a discrete or redundant system:

- An authenticator to guard against and detect identity crime, forgery, counterfeiting, and other frauds
- A diagnostic device with application in medical, agricultural and environmental diagnostics
- A reliable information source

Reading full spectrum color patterns, as well as signatures just outside the visible color

spectrum, means the Visualant system is more robust and accurate when compared to the competition which use black and white readings. In addition to its accuracy, it is faster, easier, and less costly to use.

Spectral Pattern Matching (“SPM”)

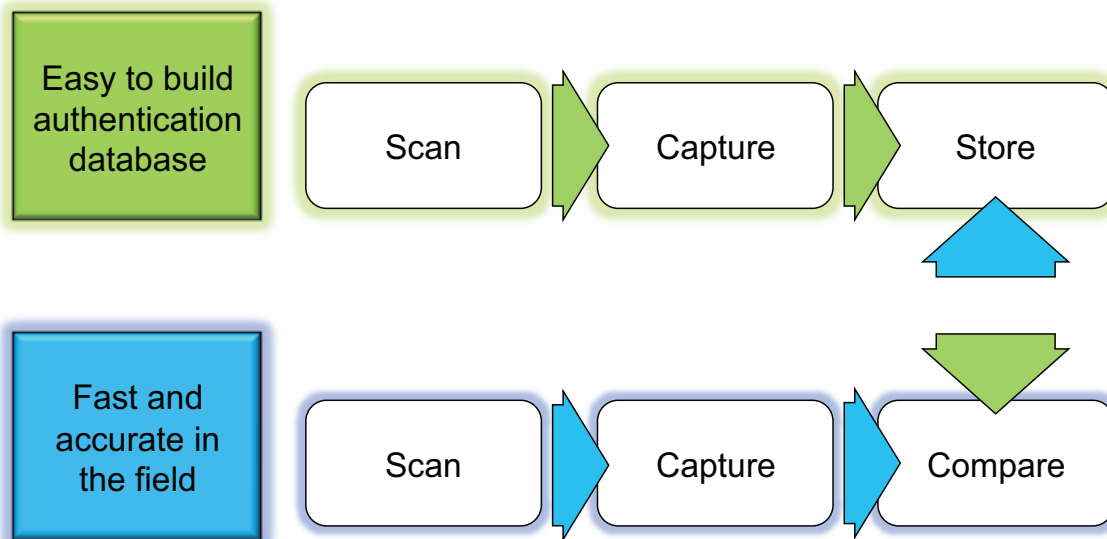
Technology...

- Can be manufactured very cost-effectively in volume
- Can be highly miniaturized
- Can be easily designed into systems or integrated into other products
 - Visualant products
 - OEM products
- Authentication database is easy to build and manage (simply scan authentic item for comparison)

Imagine...

- Imagine being able to search a pattern database of passport photos of every US citizen within seconds to confirm their identity or to confirm whether or not the driver’s license being presented to a law enforcement agent is authentic or a fake. Now add that capability to multiple other forms of identity such as government-issued identification documents, state identification cards, military identification, birth certificates, National ID Cards; virtually anything that includes a photograph and/or physical description of the holder.
- Imagine a technology capable of identifying counterfeit currency without adding new layers of ink, watermarks, holograms, or other methods of security that sophisticated criminals always seem to beat.
- Imagine a barcode you cannot see which contains far more information than current

Visualant Spectral Pattern Matching



SOURCE: Intellectual Property, Visualant Business Plan, 2011

barcode technology can deliver. Consider a single, invisible small dot carrying pieces of coded identity information, located on a security pass, passport, or shipping container.

- Imagine a technology that can help define and diagnose disease; determine the health of a plant or the environmental quality of a substance.
- Imagine a small device the size of a pen used to identify illicit substances, counterfeit money, and stolen/knock-off goods.



Real World Applications

■ Currency Counterfeiting

The U.S. Treasury recently ruined 30% of a recent printing of \$100 bills because they were too hard to print.

With automated spectral pattern imaging, costly counterfeit measures would not be necessary. Visualant's technology is capable of identifying counterfeit currency without adding new layers of ink, watermarks, holograms, or other methods of security that sophisticated criminals always seem to beat.

■ Credit Card/Debit Card Fraud

In 2010 the Credit Card Industry association reported \$12 billion in fraud against their issuing banks and financial services companies. A significant part of this fraud was perpetrated using fake cards. ATM debit card fraud is reaching \$5 billion a year.

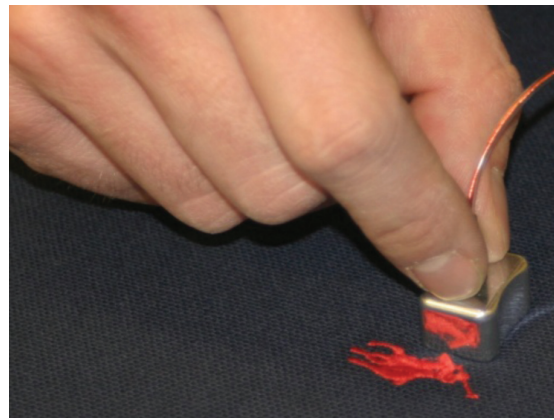
With automated spectral pattern imaging included in check-out POS machines and ATM, billions in fraud would be prevented.



■ Illicit Substance Identification

Visualant's SPM technology can be used to identify illicit substances. Visualant's SPM technology uses a proprietary micro-miniature camera that illuminates a subject multiple times with changing combinations of colored light. The unique spectral pattern is detected and compared with unprecedented precision and accuracy so that cocaine and other illicit drugs, pharmaceutical compounds, or table salt can be positively identified instantly. Not to mention fake Viagra or explosives like C4.

With the wave of one pen-like wireless sensor, a pharmacist can certify a drug's authenticity. A doctor can distinguish anthrax from baking powder.



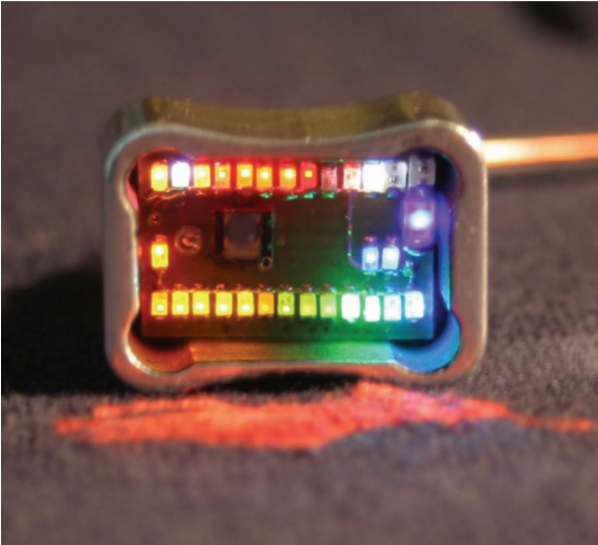
■ Product Authentication

Dyes, chemicals, and natural pigments possess unique spectral signatures invisible to the human eye but absolutely unique, like a fingerprint or DNA. Yes, Visualant's SPM technology can be used to verify a \$100 bill is authentic. But what if your FedEx or UPS driver could provide proof that the Louis Vuitton bag you bought online was authentic or a knock off? Would you pay a little extra for "authenticity insurance"?

Other product authentication solutions include:

- **Biometric Solutions** - Provides biometric solutions that utilize unique human characteristics used in place of a traditional (PIN), or other object used to authorize a transaction.
- **Software Solutions** - Customized software solutions for the ID authentication market.
- **ID and Badging** - Technology for ID badging and access control solutions.





■ Document Verification

Visualant's technology can be used to confirm whether the driver's license, military identification, or birth certificate being presented to a law enforcement agent is authentic or a fake. It can be used as an authenticator to guard against and detect identity crime, forgery, counterfeiting, and other frauds.

It can embed a single, invisible small dot barcode carrying coded identity information on a security pass, passport, or shipping container. This new technology provides far more information than current barcode technology can deliver.

■ The Technology: Up Close

Visualant's patent-pending sensor technology turns conventional spectroscopy on its head. Rather than illuminating a specimen with broadband white light then using a prism and mirrors to separate wavelengths onto a large array of detectors, VSUL illuminates the specimen with multiple light emitting diodes (LEDs) sources each calibrated to individual narrowband spectra and measure the reflected light with a single detector eliminating the need for prisms and mirrors.

This technology allows VSUL to produce industry-specific, portable, robust spectral analysis tools that are inexpensive, extremely small, and do not require constant calibration.

The simplest of the current sensors contains a single photodiode light sensor and multiple surface-mount (LEDs) that project different spectra of light. In the simplest driving scheme, the LEDs are turned on, one at a time to project light onto a specimen. The specimen reflects a portion of the light back to the photodiode of the sensor which converts the light energy to an output voltage level—essentially taking a snapshot of the specimen for each LED. The photodiode voltage levels form a spectral signature for the specimen which is then recorded to a small file.

The sensor collects a spectral signature of a paint sample and sends data to a host computer. The software interface on the computer can be navigated with a mouse or with verbal commands captured with speech recognition algorithms—enabling hands-free control of the device for a user in the field. The sensor acquires multiple spectral signatures per second, and plots them in real time on the screen for the user. A set of proprietary algorithms compares the spectral signature to a database of known signatures, and quantifies the closeness of the match. For example, the specimen is identified as paint sample W-F-720 and the signatures are a 99.682% match. New items can be added to the database on the fly. The database can be stored locally in a mobile device, on a nearby computer, or on a remote server. Proprietary encryption algorithms are used to transmit spectral signatures to a remote server.

Advantages of SPM System

Inexpensive—LEDs are a mass-produced commodity items and thus are very inexpensive enabling Visualant to produce the device at a fraction of the cost of competing technologies.

Conversely, customers are used to purchasing spectrophotometers and associated software for tens of thousands of dollars. This advantage alone allows Visualant to put an inexpensive spectral analysis tool in the hands of every enforcement agent or officer whether it be for counterfeiting or drug related enforcement issues. In one test Visualant had ten test tubes full of white powders which all appeared the same to the human eye. The sensor could easily pick out which one was which and identify it. The device and software package are also ideally suited for comparing branded or real pharmaceuticals vs. counterfeit pharmaceuticals.

Small and lightweight—Current sensors are the diameter of a dime. Because of its size a complete USB portable device containing 8 GB of memory, a CPU, and LCD screen could all be incorporated and manufactured in a unit about the size of a Bic lighter. VSUL is currently looking for working partners in this area.

High speed—The pictured sensor scans approximately ten objects per second, and the sensor now being developed is capable of scanning thousands of objects per second.

The company has six patents pending in the United States and one patent pending in Japan

The Business Model

The company is in the business of researching, developing, acquiring, and commercializing products and services related to illumination and detection of electromagnetic energy, typically in the visible and near-visible portions of the electromagnetic spectrum, using specialized illumination and sensing systems and spatial analysis software modeling which allow for pattern recognition. This SPM technology is specialized and proprietary.

Key Market Priorities

- Commercialize the Visualant product line and close sales in the United States and Japan.
- Implement synergies between TransTech acquisition and the company.
- Develop license- and royalty-producing opportunities for the SPM technology.
- Improve profitability of the company by increasing sales and managing expenses.
- Acquire growth businesses at discounted prices in target sectors and markets in conjunction with business partners. Visualant expects to focus on growth opportunities with distressed businesses that require improvements in management, financial processes, and liquidity to be successful.
- Leverage the company's presence in Asia utilizing their Japanese directors.
- Enhance our investor relations services.
- Expand the existing relationship with RATLab and Novabeam and their development of medical, agricultural, and environmental applications.

The Visualant M&A Business Model

Visualant's strategy is to accelerate market entry and penetration through the acquisition of well-operated and positioned distributors of security and authentication systems like TransTech. This consolidation strategy creates a natural distribution channel for products featuring the company's proprietary Spectrum Pattern Matching (SPM) technology.

This will accelerate the company's access to national distribution channels and an established base of customers, enabling Visualant to create new and enhance existing products based on Visualant's SPM technology. This strategy will also stimulate product sales and generate new revenue, enhancing profitability across the entire distribution network.

The TransTech Acquisition

TransTech Systems, Inc. (www.ttsys.com), a subsidiary of Visualant, Inc., is a provider of industry-leading identification solutions. TransTech has created a distribution channel for its premier ID-Badging and access control security products by searching out the newest technologies and building and maintaining customer and cutting-edge industry supplier partnerships, all supported by TransTech's exceptional service.

SEATTLE—(BUSINESS WIRE)—TransTech Systems, Inc. ("TransTech"), a subsidiary of Visualant, Inc. (OTCBB:[VSUL.ob](#) - [News](#)), a pioneer provider of industry-leading identification solutions, is pleased to announce it has been awarded a new contract from a major North American defense and aerospace contractor.

The contract involves the sale of a high-end digital video capture technology solution which will be integrated into the company's enterprise-wide employee badging system.

Once again TransTech has been selected as the provider for the worldwide employee badge printing systems of this unidentified Fortune 50 manufacturing company.

TransTech has worked consistently with this customer since 2002. The latest award is a continuing vote of confidence in the customer's satisfaction with TransTech's historic performance and the ability of TransTech to meet the company's future needs as identification and certification requirements continue to evolve.

Jim Gingo, TransTech President, said, "We are proud of our long-term relationship with this customer. We work hard to always provide consistent professional service. This new contract reinforces our relationship and our commitment to sustained excellence."

TransTech Acquisition: Deal Terms

Visualant, Inc., an emerging leader in authentication systems technology, announced that the acquisition of TransTech Systems, Inc., closed on June 8, 2010.

TransTech, founded in 1994, is a distributor of access control and authentication systems serving the security and law enforcement markets. With recorded revenues of approximately \$10 million in 2009, TransTech has a respected national reputation for outstanding product knowledge, sales and service excellence.

The company acquired its 100% interest in TransTech by issuing a promissory note to James Gingo, the President of TransTech, in the amount of \$2,300,000, plus interest at the rate of 3.5% per annum from the date of the note. The note is secured by a security interest in the stock and assets of TransTech, and is payable over a period of three years as follows:

(i) The sum of \$650,000, the amount of any accrued interest due on the debt of \$600,000 owed by James Gingo to the Bonderson Family Living Trust and interest on the unpaid balance, shall be paid to seller on the earlier of: (A) the one-year anniversary of the closing date; or (B) on the closing of \$2,500,000 or more in aggregate financing (whether debt, equity or some combination thereof) after the closing date;

(ii) The sum of \$650,000, the amount of any accrued interest due on the Bonderson debt owed by TransTech and interest on the unpaid balance shall be paid to seller on the earlier of: (A) the two-year anniversary of the closing date; or (B) on the closing of \$5,000,000 or more in aggregate financing (whether debt, equity or some combination thereof) after the closing date; and

(iii) The remaining balance of the note and interest thereon shall be paid to seller on the earlier of: (A) the three-year anniversary of the closing date; or (B) on the closing of \$7,500,000 or more in aggregate financing (whether debt, equity or some combination thereof) after the closing date.

On June 8, 2010, the company issued a total of 3,800,000 shares of restricted common stock of the company to Jim Gingo, Jeff Kruse and Steve Waddle, executives of TransTech, and Paul Bonderson, a TransTech investor. The parties valued the shares in this transaction at \$76,000 or \$0.02 per share, the closing bid price during negotiations.

BFI Finance Corp Secured Credit Facility

On December 9, 2008 TransTech entered into a \$1,000,000 secured credit facility with BFI Finance Corp to fund its operations. The rate is prime interest + 2.5%, with a floor for prime interest of 5.5%. On June 12, 2010, the secured credit facility was renewed for six months, with a floor for prime of 4.5%. The eligible borrowing is based on 80% of eligible trade accounts receivable, not to exceed \$700,000, and 35% of inventory value, not to exceed \$300,000, for a total cap of \$1,000,000. As of September, 2010, the outstanding balance under this facility was \$643,000. The secured credit facility is guaranteed by Jim Gingo, the President of TransTech.

Management Team

Ronald P. Erickson **CEO, President and Chairman of the Board**

Mr. Erickson has been a director and officer of the Company since April 24, 2003. He currently serves as the Company's Chairman, Chief Executive Officer and President. He was appointed to the positions of CEO and President on November 10, 2009. Earlier, he was appointed President and Chief Executive Officer of the Company on September 29, 2003, and resigned from this position on August 31, 2004 at which time he was appointed Chairman of the Board. A seasoned executive with more than 30 years of experience in the high technology, telecommunications, micro-computer, and digital media industries, Mr. Erickson was the founder of Visualant. In addition to his Visualant responsibilities he also serves as Chairman of ivi, Inc. a streaming media company and eCharge Corporation an Internet based transaction processing company. He is formerly Chairman, CEO and Co-Founder of Blue Frog Media, a mobile media and entertainment company; Chairman, CEO and Co-founder of GlobalTel Resources, a provider of telecommunications services; Chairman, Interim President and CEO of Egghead Software, Inc. the large software reseller where he was an original investor; Chairman and CEO of NBI, Inc.; and Co-founder of MicroRim, Inc. the database software developer. Earlier, Mr. Erickson practiced law in Seattle and worked in public policy in Washington, DC and New York, NY. Additionally, Mr. Erickson has been an angel investor and board member of a number of public and private technology companies. Mr. Erickson has a BA from Central Washington University, a MA from the University of Wyoming and a JD from the University of California, Davis. He is licensed to practice law in the State of Washington and the District of Columbia.

Mark Scott **Chief Financial Officer**

Mr. Scott has served as Chief Financial Officer, Secretary and Treasurer since May 2010. He has significant financial, capital market and relations experience in public microcap companies. Mr. Scott continues to serve as Chief Financial Officer of IA Global, Inc., a position he has held since October 2003. Previously, he held executive financial positions with Digital Lightwave; Network Access Solutions; and Teltronics, Inc. He has also held senior financial positions at Protel, Inc., Crystals International, Inc., Ranks Hovis McDougall, LLP and Britannia Sportswear, and worked at Arthur Andersen. As a member of the National Association of Corporate Directors, Mr. Scott is a certified corporate director. Mr. Scott is also a certified public accountant.

Yoshitami Arai **Visualant Board of Directors**

Mr. Arai has served as an independent director since October 8, 2008. Mr. Arai brings strategic experience, a broad global business network, and sophisticated business acumen to the board. He has performed in many professional and civic capacities throughout Japan and abroad, and has served as Director and Senior Executive of international organizations including 7-Eleven, Tokyu Hotels, Systems International, Catalina Marketing and Sony.

Paul Bonderson **Visualant Board of Directors**

Mr. Bonderson has served as an independent director since June 8, 2010. Mr. Bonderson has more than 30 years of technical experience in the computer industry, spanning both hardware and software engineering, engineering management, and product development. Prior to co-founding Brocade, Bonderson held engineering management positions at industry leading companies including Intel Corporation and Sun Microsystems, Inc. Since retiring from Brocade,

Bonderson has been an active philanthropist. He is a member of the Board of Trustees of the Wetlands America Trust, Inc., the organization responsible for managing the endowment and land holdings of Ducks Unlimited. He is also a Senior Advisory Vice President and Board Member of Ducks Unlimited. Additionally, Mr. Bonderson serves on the Advisory Committee of the School of Engineering and the Foundation Board of California Polytechnic State University, San Luis Obispo, California.

James Gingo **Visualant Board of Directors**

James Gingo has served as an independent director since June 8, 2010. TransTech was founded in 1994 and has been led by Mr. Gingo as its President and founder since then. TransTech is a distributor of access control and authentication systems serving the security and law enforcement markets. Mr. Gingo's guidance, experience and great depth of knowledge combined to make TransTech a respected national reputation for outstanding product knowledge, sales and service excellence. James Gingo is a highly regarded industry veteran and one of the early members of the Document Security Alliance, an organization co-founded by the United States Secret Service and concerned industry representatives after the events of 9/11. He sits on the Board of the Security Industry Association.

Marco Hegyi **Visualant Board of Directors**

Marco Hegyi has served as an independent director since February 14, 2008. Mr. Hegyi has been a principal with the Chasm Group since 2006, where he combines his expertise in, and passion for helping companies expand their businesses with innovative technologies and collaborative partnership strategies using mobile and wireless platforms, service business models and Internet marketing programs.

Prior to working as a strategic advisor, Mr. Hegyi served as Senior Director, Global Product Management, at Yahoo Search Marketing during 2006. Prior to Yahoo, Mr. Hegyi was at Microsoft leading program management for Microsoft Windows and Office beta releases aimed at software developers from 2001 to 2006. While at Microsoft, he formed new service concepts and created operating programs to extend the depth and breadth of the company's unparalleled developer eco-system, including managing offshore, outsource teams in China and India, and being the named inventor of a filed Microsoft patent for a business process in service delivery.

Mr. Hegyi earned a Bachelor of Science degree in Information and Computer Sciences from the University of California, Irvine, and has completed advanced studies in innovation marketing, advanced management, and strategy at Harvard Business School, Stanford University, UCLA Anderson Graduate School of Management, and MIT Sloan School of Management.

Dr. Masahiro Kawahata, Ph.D. **Chair of Scientific Advisory Committee** **Visualant Board of Directors**

Dr. Kawahata has served as an independent director since April 19, 2006. Dr. Kawahata is the former Director of the Fujitsu Research Institute. He is known in Japan as "the father of multimedia" for his work as National Program Director in developing the nationwide fiber optic network. Early in 2005, the U.S. Government officially acknowledged him as "Non-U.S. Scientist of Extraordinary Ability". Dr. Kawahata has taught at Tokai University, is a Consulting Professor at Stanford University, Provost's Distinguished Professor at the University of Southern California and Visiting Professor at the University of Washington. He has served as a Director of numerous technology companies, and has received several prestigious awards in the United States and Japan.

Jon Pepper **Visualant Board of Directors**

Jon Pepper has served as an independent director since April 19, 2006. Mr. Pepper is the co-founder of Pepcom [www.pepcom.com], an industry leader at producing press-only technology showcase events around the country. Prior to that Pepper started the DigitalFocus newsletter, a ground-breaking newsletter on digital imaging that went to leading influencers worldwide. Pepper has been closely involved with the high technology revolution since the beginning of the personal computer era. He was formerly a well-regarded journalist and columnist; his work on technology subjects appeared in The New York Times, Fortune, PC Magazine, Men's Journal, Working Woman, PC Week, Popular Science and many other well known publications. Pepper was educated at Union College in Schenectady, New York and the Royal Academy of Fine Arts in Copenhagen.

Bradley E. Sparks **Visualant Board of Directors**

Bradley Sparks currently serves as a director. On November 12, 2009, Mr. Sparks resigned as the Company's Chief Executive Officer and President. He held these positions since November 2006. Mr. Sparks currently serves as the Chief Financial Officer for Laredo Oil, Inc. Before joining Visualant in 2006, he served as Chief Financial Officer of WatchGuard Technologies, Inc. from 2005-2006. Previous to WatchGuard, he was the founder and managing director of Sunburst Growth Ventures, LLC, a private investment firm specializing in emerging-growth companies. Earlier, he founded Pointer Communications and served as Chief Financial Officer for several publicly-held telecommunications companies, including eSpire Communications, Inc., Digex, Inc., Omnipoint Corporation, and WAM!NET. He also served as Vice President and Treasurer of MCI Communications from 1988-1993 and as Vice

President and Controller from 1993-1995. Before his tenure at MCI, Mr. Sparks held various financial management positions at Ryder System, Inc.

Mr. Sparks also serves on the Board of Directors for iCIMS, a privately-held software company and Comrise China, also a privately-held company. Mr. Sparks graduated from the United States Military Academy at West Point and is a former Army Captain in the Signal Corps. He has an MS in Management from the Sloan School of Management at MIT and is a licensed CPA in Florida.

VSUL Capital Structure

On December 7, 2009, the company obtained \$250,000 of financing from Coach Capital pursuant to a convertible promissory note. The note accrues interest at 8% and may be converted into restricted common stock on November 27, 2010, at \$0.15 per share. This financing places certain restrictions on the company. Additionally, Coach Capital received warrants to purchase 833,333 shares of the company's common stock at \$0.15 per share. The warrant expires three years from the date of issuance.

Upon issuing the note to Coach Capital, the Company recognized the note and warrants based on their relative fair values of \$250,000 and \$81,000, respectively. The fair value of the note was determined using the Black-Scholes option pricing model. The relative fair value of the warrants was classified as a component of additional paid-in capital with the corresponding amount reflected as a contra-liability to the debt. The fair value of the warrants was determined using the Black-Scholes model, assuming a term of three years, volatility of 267%, no dividends, and a risk-free interest rate of 1.34%.

The convertible note payable balance as of September 30, 2010, net of \$11,153 in warrant debt discount, was \$238,847. The company

expensed \$16,438 in interest during the year ended September 30, 2010.

During the quarter ended December 31, 2009, the company issued 300,000 shares of common stock as grants to directors, 100,000 shares of common stock as grants to a consultant, and 300,000 shares to RATLab.

On May 10, 2010, the Board of Directors issued to Mark Scott, Chief Financial Officer, 1,000,000 shares of restricted common stock to be granted upon signing at the closing bid price of \$.02 per share on May 7, 2010.

On May 10, 2010, the Board of Directors approved the issuance to Ron Erickson or his designee of 2,000,000 shares of restricted common stock in the company and the grant of options to purchase 3,000,000 shares at \$0.15 per share. The restricted common stock was issued at the closing bid price of \$.02 per share on May 7, 2010. The grant of options vests quarterly over two years and expires on May 6, 2020. This common stock issuance and the grant of options replace the 5,000,000 unissued shares previously approved by the Board of Directors on December 21, 2009.

On May 18, 2010, the Board of Directors issued 600,000 shares of restricted common stock of the company to four consultants and suppliers for the conversion of liabilities or for services. The parties valued the shares in this transaction at \$0.02 per share, the closing bid price of the company's common stock during negotiations.

On June 1, 2010, the Board of Directors issued 666,667 shares of restricted common stock of the company to a service provider for the conversion of \$100,000 in liabilities at \$.15 per share.

On June 8, 2010, the Board of Directors issued 3,000,000, 100,000 and 100,000 of restricted common stock of the company to Jim Gingo, Jeff Kruse and Steve Waddle, executives of

TransTech, respectively. The parties valued the shares in this transaction at \$0.02 per share, the closing bid price of the company's common stock during negotiations.

On June 8, 2010, the Board of Directors issued 600,000 shares of restricted common stock of the company to Paul Bonderson, a TransTech investor. The parties valued the shares in this transaction at \$0.02 per share, the closing bid price of the company's common stock during negotiations.

On June 8, 2010, the Board of Directors issued 300,000 shares of restricted common stock of the company to David Markowski for consulting services. The parties valued the shares in this transaction at \$0.02 per share, the closing bid price of the company's common stock during negotiations.

On June 11, 2010, the company issued a warrant for the purchase of 300,000 shares of common stock of the company to the Sterling Fund for advisory services. The warrant was valued at \$.02 per share using the Black-Scholes-Merton option valuation model. The warrant expires June 10, 2013 and is callable if registered and with five closing trading prices of the company's common stock over \$.50 per share.

Stock Option Activity

In 2005, the Board of Directors adopted a combined incentive and nonqualified stock option plan for employees, consultants, suppliers and directors. On October 9, 2006 the Board of Directors authorized an increase in shares available for grant from 2 million to 4 million, subject to stockholder approval. The stock option plan has never been approved by the shareholders and stock option grants are considered non-statutory.

On May 10, 2010, the Board of Directors authorized to Ron Erickson or his designee the grant of non-qualified options to purchase 3,000,000 shares of the company's common stock at \$0.15 per share. The non-qualified stock option grant vests quarterly over two years and expires in ten years.

On June 8, 2010, the Board of Directors granted Mr. Kruse and Mr. Waddle, executives at TransTech, options to purchase 300,000 and 200,000 shares, respectively, of the company's common stock. The awards were granted at the price of \$0.09 per share, the bid price on the date the TransTech acquisition documents were approved. In accordance with the 2005 stock option plan, the stock option grants vest quarterly over three years and expire in ten years.

On September 21, 2010, Peter Ettinger forfeited a stock option grant for 75,000 shares of the company's common stock.

There are currently 4,735,000 options to purchase common stock at \$.288 per share outstanding at September 30, 2010 under the 2005 stock option plan. The company recorded \$152,053 and \$139,787 of compensation expense, net of related tax effects, relative to stock options for the year ended September 30, 2010. As of September, 2010, there is approximately \$287,472 of total unrecognized costs related to employee granted stock options

that are not vested. These costs are expected to be recognized over a period of approximately three years.

Seaside 88 Advisors, LLC Stock Purchase Agreement

On December 23, 2010, Visualant, Inc., entered into a securities purchase agreement with Seaside 88 Advisors LLC, pursuant to which Seaside agreed to purchase restricted shares of the company's common stock from time to time over a twelve-month period, provided that certain conditions are met.

Under the terms of the agreement, the company has the right to sell and issue to Seaside restricted shares of the company's common stock over a twelve-month period commencing on the closing date. Visualant will be entitled to sell shares each month during the following twelve months, subject to certain conditions and limitations. With respect to each subsequent closing, Visualant will not be obligated to sell any of its common stock to Seaside at a price lower than \$0.25 per share, and Seaside's beneficial ownership of the company's common stock will not exceed 4.99%. Seaside is not permitted to short sale the company's common stock.

Visualant has agreed to pay Seaside's legal fees and expenses in the amount of \$25,000 for the initial closing, and \$2,500 for each subsequent closing. Visualant also has agreed to pay 7.0% in finder's fees (to be paid in connection with each draw down) and issue 10,113 common stock warrants exercisable at \$0.21395 per share.

The agreement may be terminated by Seaside (i) upon written notice to the company if the initial closing has not been consummated on or before December 31, 2010; or (ii) upon written notice to the company, if at any time prior to the final subsequent closing the company consummates a financing to which Seaside is not a party.

The agreement also contains certain representations and warranties of Visualant and Seaside, including customary investment-related representations provided by Seaside, as well as acknowledgements by Seaside that it has reviewed certain disclosures of the company (including the periodic reports that the company has filed with the SEC) and that the company's issuance of the shares has not been registered with the SEC or qualified under any state securities laws. Visualant provided customary representations regarding, among other things, its organization, capital structure, subsidiaries, disclosure reports, absence of certain legal or governmental proceedings, financial statements, tax matters, insurance matters, real property and other assets, and compliance with applicable laws and regulations. Seaside's representations and warranties are qualified in their entirety (to the extent applicable) by the company's disclosures in the reports it files with the SEC. Visualant also delivered confidential disclosure schedules qualifying certain of its representations and warranties in connection with executing and delivering the agreement.

EMPLOYMENT AGREEMENTS

Agreement with Mark Scott

On May 10, 2010, the Board of Directors approved the appointment of Mr. Scott as Chief Financial Officer based on: (i) cash compensation of \$2,000 per month until cash is available at which time cash compensation shall be increased to \$8,000 per month; (ii) bonus cash compensation; shall be at the discretion of the senior executive and the board of directors; (iii) benefits after the closing of funding at discretion of Mr. Scott and equivalent to other employees in the company; and (iv) 1,000,000 shares of restricted common stock to be granted upon signing at the closing bid price of \$.02 per share on May 7, 2010

Agreement with Jim Gingo

On June 8, 2010, the company entered into an employment agreement with Mr. Jim Gingo, Founder and President of TransTech. The agreement has a three year term beginning on June 8, 2010 at the annual base salary of \$200,000 per year. The agreement provides for participation in the company's benefit programs available to other employees (including group insurance arrangements). Under the agreement, Mr. Gingo is also eligible for discretionary performance bonuses based upon performance criteria to be determined by the company's compensation committee based on criteria under development up to 50% of his annual salary. If Mr. Gingo's employment is terminated without Cause (as defined in the agreement), Mr. Gingo will be entitled to a payment equal to one year's annual base salary paid over the next year.

Accounts Payable Owed to Related Parties

Mr. Sparks is owed \$721,333 of accrued salary plus \$63,134 which has been accrued to pay applicable payroll taxes, unemployment taxes, etc. Additionally, interest of \$33,011 is owed Mr. Sparks for the note payable described in Note 11 to these Notes to Financial Statements. Mr. Sparks is also owed \$28,793 for cash amounts advanced by him to Visualant to fund operating expenses since his employment.

Mr. Erickson is owed \$2,270 for expenses on behalf of the company totaling an additional \$14,310. Such expenses are recorded in accounts payable from related parties. Mr. Erickson became CEO and President on November 12, 2009.

Dr. Kawahata, one of the company's directors, is owed \$90,681 by Visualant for services rendered to the company.

Key Communications

Visualant, Inc. (OTCBB:[VSUL.ob](#) - [News](#)), a pioneer provider of industry-leading identification solutions, issued the following shareholder letter:

December 2, 2010

Dear Visualant Shareholders:

We recently completed the first demonstration unit of the Visualant Spectral Pattern Matching (SPM) technology. This world-class technology has been eagerly awaited by many in the fields of security, authentication and all forms of diagnostics who have viewed the technology in the laboratory. This demonstration unit has been a long time in making the transition from the lab bench to the approximate size of a smart phone. The demo unit provides an excellent opportunity to showcase the SPM technology to potential customers around the world. The demo unit size and portability is indicative of the low cost and form factor flexibility inherent in the Visualant technology. This demo unit now brings Visualant one step closer to commercialization. Our next step in this process is to work with our development team to create a Developer's Kit to enable potential customers to create their own solutions utilizing SPM technology.

Our merger and acquisition strategy led us to TransTech Systems, Inc., our newly acquired subsidiary. TransTech brings its first-class reputation to our company. With annual revenues of approximately \$10 million and a nationwide base of 500 dealers, TransTech brings Visualant close to the customer. Our stated goal is to grow the Company through additional acquisitions to \$35 to \$50 million in revenues. We are working closely with TransTech senior management to identify more acquisition opportunities in the security and authentication marketplace. At the same time we are working to organically grow the base TransTech business.

The demonstration unit had its first public unveiling at the TransTech Systems booth at the ASIS show in Dallas, TX, from October 12 to October 15. We had a very positive response at the show and again at the ISC Solutions Expo in New York City on November 1 to November 4, where TransTech also had a presence.

In a note after the trade shows Jim Gingo, TransTech President, wrote, "The TransTech booth was continually busy, with many interested parties looking at our 'fascinating' Visualant handheld prototype unit. Our staff set up a simple, but effective, demonstration that compared seemingly identical 4-color dye ribbons, showing a capability of the demo unit to distinguish between real and counterfeit ribbons (a large source of consternation in the card printing industry in particular.) As well, we were able to differentiate different types of plastic card stock and, yes, of course, even unmarked white powders."

Jim Gingo's respected position in the industry was acknowledged when the Security Industry Association held its annual meeting in New York in conjunction with the ISC Solutions Expo. Jim was

elected to the Executive Committee of the Security Industry Association and became its Treasurer. Jim had previously served two terms on the Board of the association.

In mid-November, Jim Gingo, and Mark Scott, Visualant CFO, visited Japan and met with potential partners for Visualant and TransTech. They also met with a number of current Japanese investors in Visualant. The result of the meetings was an overtly positive response to the Visualant demo unit. We anticipate forming many new relationships in both product development and product deployment. These meetings were arranged by our two Visualant Board members from Japan, Dr. Masahiro Kawahata and Mr. Tom Arai. Many of you recall that Dr. Kawahata is a well-regarded scientist in Japan, formerly the head of the Fujitsu Research Center and a Professor at Tokai University. Mr. Arai is a prominent businessman in Japan and was a long-term member of the board of 7-Eleven and other major corporations.

The Visualant fiscal year ends on September 30, 2010. Our annual report in the form of our 10-K filing with the Securities and Exchange Commission will be filed around the end of the year. We expect to have a shareholders meeting early in 2011. Please be on the alert for notice of that meeting.

This is the second in an ongoing series of periodic newsletters to our shareholders. We will post these newsletters on the Visualant website at www.visualant.net. If we have an email address for you, we will send you a copy of these newsletters electronically. If you have not already done so, please enter your email and other information on the form on the website at: <http://visualant.net/contactus.html>.

In the meanwhile, thank you for your continued support. Please do not hesitate to be in touch with us if you have any questions. And, once again, please sign up on the website so that we can communicate with you.

Sincerely,

Ron Erickson
Chairman and Chief Executive Officer

NBT Equity Research

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