Zacks Small-Cap Research

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Pure Bioscience, Inc. (PURE-OTC)

PURE: Revenue growth will resume in calendar 2H14, a reborn company with new focus on food safety—Outperform

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	10/16/2013
Current Price (03/14/14)	$1.29
Twelve- Month Target Price	**$3.00**

OUTLOOK

PURE develops and markets SDC-based antimicrobial products that provide non-toxic solutions to numerous global health challenges. SDC is a novel, patented platform technology with superior efficacy and low toxicity and can be used in diverse markets including food safety, personal care, preservatives, industrials, agriculture and pharmaceuticals.

After recent massive management change, PURE is refocusing on the food safety industry. We expect growth will resume in calendar 2H14. We maintain Outperform rating for PURE shares.

SUMMARY DATA

52-Week High	**$1.65**
52-Week Low	**$0.28**
One-Year Return (%)	**36.36**
Beta	**0.43**
Average Daily Volume (sh)	**124,614**
Shares Outstanding (mil)	**27**
Market Capitalization ($mil)	**$35**
Short Interest Ratio (days)	**3.92**
Institutional Ownership (%)	**9**
Insider Ownership (%)	**13**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**36.6**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2011 Estimate	**N/A**
P/E using 2012 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**High,**
Type of Stock	**Small-Growth**
Industry	**Med Products**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Oct)	Q2 (Jan)	Q3 (Apr)	Q4 (Jul)	Year (Jul)
2013	0.11 A	0.26 A	0.26 A	0.19 A	0.82 A
2014	0.12 A	0.04 A	0.15 E	0.35 E	0.66 E
2015					4.50 E
2016					12.00 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Oct)	Q2 (Jan)	Q3 (Apr)	Q4 (Jul)	Year (Jul)
2013	-$0.25 A	-$0.17 A	-$0.14 A	-$0.17 A	-$0.71 A
2014	-$0.06 A	-$0.03 A	-$0.05 E	-$0.05 E	-$0.19 E
2015					-$0.11 E
2016					$0.02 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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WHAT'S NEW

- Fiscal 2Q14 financials were disappointing, but growth is expected to resume in calendar 2H14;
- Balance sheet cleaned and boosted;
- Experienced, results—oriented new management team;
- Laser focused on food safety segment;
- Valuation very attractive; maintain Outperform rating and raise 12-month target price to $3.00;

2Q14 financials disappointing, but Growth Expected to resume in Calendar 2H14

On March 13, PURE reported fiscal second quarter financials for the three month ended Jan 31, 2014.

Revenues for 2Q14 were $41,000, compared with revenues of $263,000 for 2Q13, a decline of 84%.

Total operating costs, excluding share-based compensation and restructuring costs, for the second fiscal quarter of 2014 and 2013, were $1.6 million, and $1.8 million, respectively.

Net loss for the second fiscal quarter of 2014 was $2.5 million, or $(0.10) per share, compared with a net loss of $1.8 million, or $(0.17) per share, in the second fiscal quarter of 2013.

The financials for fiscal 2Q14 ended Jan 31, 2014 were certainly disappointing to us. But we remind investors PURE has just completed the restructuring, and is reborn as a new company with refocused strategy.

We think the new management team has built significant momentum on its refocused business strategy to commercialize its SDC-based technology as a food safety solution. PURE received initial orders from its first three national food processors customers and one multi-national food processor with customer rollout plans in development. Pure also completed final in-store testing with a national brand QSR (quick service restaurant), confirming multiple outstanding prior testing results, where SDC-based products have continually been demonstrated to provide superior efficacy.

The company also reduced its non-core operating activities by out-sourcing its manufacturing operations through a strategic collaboration agreement. Comprehensive manufacturing transfer will be completed by March 2014, which will reduce future facilities costs over 50%.

Recently, PURE has established two agreements with its partners to distribute its products. One is with Brenntag Specialities, Inc., and another one is with Intercon Chemical Company. These two new agreements along with existing distribution agreements should help boost sales in the coming quarters.

With new management and new strategy, we believe revenue will resume growing in **second half of calendar 2014**. We estimate total revenue for fiscal 2015 will reach $4.5 million, representing an increase of 586% over fiscal 2014. Positive EBITDA will be achieved by fiscal 4Q15 (July 31, 2015). PURE will become profitable in fiscal 2016 based on total revenue of $12 million according to our financial model. Earnings per share will reach $0.16 by fiscal 2017.

Balance Sheet Cleaned and Boosted

At January 31, 2014, PURE had $236,000 in cash and cash equivalents. On a pro forma basis, the adjusted cash position as of January 31, 2014 would be $1.5 million, reflecting the additional $1.3 million in proceeds from the sale of 1.35 million shares of common stock raised through private equity placements, as reported in its 10-Q filed on March 13, 2014.

During the fiscal 2Q14, PURE extinguished early a promissory note of $1.125 million in principal and other accrued costs for approximately $500,000, resulting in a gain on extinguishment of debt of $727,000. As a consequence, as of January 31, 2014, the Company has **no long-term debt**.

Pure also reported that total stockholders' equity increased $1.9 million to $890,000 as of January 31, 2014 as compared with July 31, 2013 total stockholders' deficit of $(991,000).

New management has been working diligently to strengthen PURE's balance sheet since they took office. Specific measures included raising new funds and reducing non-core operating activities.

By reducing its non-core operating activities, PURE should be able to reduce its burn rate significantly in the next few quarters.

The process to restore PURE's financial condition will take several steps and we are pleased to see that the company has already made significant strides. We believe the fiscal year 2014 will be both challenging and rewarding as the company sharply focuses on commercializing its patented SDC-based products in the food industry.

The Refocused Strategy

In mid-2013, PURE initiated management change and corporate restructuring in order to establish new and experienced leadership focused on commercialization of SDC technology in the food industry as a unique and proprietary antimicrobial agent to protect consumer safety against various pathogens.

The Company's near-term business focus is to drive customer adoption of its products in the **food safety industry**. Its proprietary SDC-based products uniquely address food safety issues across the supply chain and help to prevent or mitigate food contamination and the potential for food-borne illness. The Company's target customers will be foodservice operators, food processors and food manufacturers.

As part of its new commercialization focus on food safety segment, PURE also strengthened its sales and marketing leadership team. In late August 2013, PURE appointed **Cliff Wechsler** as its new Executive Vice President of Sales, and **Tom Myers** assumed the position of Executive Vice President of Marketing and Product Development.

Mr. Wechsler brings over 30 years of experience, having previously served in a variety of high level sales management positions with Kraft Foods. During his tenure at Kraft Foods Mr. Wechsler shaped and developed the business strategy for their Quick Service Restaurant (QSR) market segment.

Mr. Myers will now lead the company's marketing and product development, having previously joined PURE in May 2011 as Executive Vice President of Sales and Marketing. Mr. Myers brings over 40 years of food industry experience, with emphasis on both food science and food processing where he served in senior leadership positions in marketing, product development and technical operations.

With the new strategy and focus, PURE has reduced costs and personnel in all departments other than sales and marketing as the company continues the push toward meaningful revenues. The company has also established high-capacity outsourcing options for manufacturing to remain positioned to timely fill orders as necessary.

PURE has cut total wage expenditures by more than 30% through the elimination of manufacturing, research and development, administrative and executive positions. The company has also reduced G&A expenses related to professional services, including legal and consulting fees, public relations and investor relations. Furthermore, PURE's corporate officers and directors have elected to defer the majority of cash compensation, effective immediately.

In summary, with the change in governance, PURE Bioscience implemented a new business strategy focused on:

- Commercialization of its SDC-based products as a food safety solution, with a focus on foodservice and food processing;
- Optimization of operations and termination of non-core activities;
- Implementation of a lean organization with the relevant experience to drive commercialization and accelerate growth;
- Active and experienced board members contributing incremental insight and guidance on business strategy and execution.

Valuation Very Attractive

We maintain our Outperform rating on PURE shares and raised our 12-month price target to $3.00 per share from previous $2.50 per share.

Our call is based on the recent progress the company has achieved and positive developments within the company as well as the attractive valuation.

PURE is a technology-based bioscience company that provides solutions to numerous global health challenges. PURE's proprietary high efficacy/low toxicity **SDC-based antimicrobials** represent innovative advances in diverse markets and lead today's global trend toward industry and consumer use of **"green" products**. Patented SDC is an electrolytically generated source of stabilized ionic silver, which formulates well with other compounds. As a platform technology, SDC is distinguished from competitors in the marketplace because of its **superior efficacy**, **reduced toxicity** and the **inability of bacteria to form a resistance** to it.

PURE's SDC is the first new disinfectant registered with EPA in over 30 years. SDC's competitive advantages in efficacy and safety make it outstanding among its competitors and represent a **paradigm shift** in the disinfectant/sanitizer market place.

Another key feature of SDC is that SDC-based products have broad applicability in diverse markets. The Company's current focus is to expand distribution of currently approved **disinfectant/sanitizer** products to consumers in the **food safety industry**.

Recent corporate governance change led to a new management, which is experienced, disciplined and results—oriented. New board will play key incremental role providing strategic insight to accelerate near term market penetration.

In terms of valuation, currently, the Company trades around $1.30 per share with a market cap of $35 million based on 27 million shares outstanding. We think this is a discount based on the company's fundamentals. According to our model, revenue will grow at 128% CAGR in the next fiscal 4 years. PURE will become profitable in fiscal 2016 with an EPS of 0.02 based on total revenue of $12.0 million. With this in mind, we think PURE shares should be traded at a P/E ratio of 30 x. Applying this P/E multiple with our estimated EPS of $0.16 per share in fiscal 2017, discounted at 20% for 3 years, we come up with a target price of $3.00. This values PURE at $81 million in market cap, which we think is still conservative.

But we remind investors to keep in mind the risks. Although its lead product PURE Hard Surface is increasingly gaining recognition, sales may take longer time to gain traction since PURE is still in its early stage of commercialization of its SDC technology. Sales so far have not been impressive. SDC technology is quite new to most customers in the disinfectant market, and the costs for SDC are also higher than those for most existing technologies. Therefore, rollout of the SDC platform will take time.

Cash burn is another concern. Current cash will only last through the third quarter of fiscal 2014 and the Company needs to tap the capital market again. Equity financing will dilute existing shareholder base. A financing deal with a strategic partner should be positive to the Company's long term growth.

COMPANY OVERVIEW

SDC Represents A Paradigm Shift For Antimicrobial Disinfectant/Sanitizer

Silver Dihydrogen Citrate (SDC) represents a **paradigm shift** for antimicrobial disinfectant and sanitizer active ingredients. It is the first new active disinfectant ingredient to be registered with the US EPA in over 35 years. SDC is an effective antimicrobial, exhibiting **broad spectrum activity with fast kill times** against bacteria (gram□positive and gram□negative), viruses (enveloped and non□enveloped) and fungi. SDC has a long shelf life and its low toxicity profile does not sacrifice efficacy. It is active against some of the most concerning pathogens in the high density living areas and community settings including MRSA, Norovirus, Influenza, *Acinetobacter*, *Klebsiella*, Vancomycin□resistant *Enterococci*, coliforms (fecal and total), *Legionella*, *E coli* O157:H7, HIV, *Salmonella*, Rotavirus, H1N1, etc.

SDC is used to disinfect and/or sanitize hard, nonporous surfaces. The PURE Hard Surface formulation is a stable, non-toxic, odorless and colorless solution which may be used in the presence of people and animals. This SDC based **Ready to Use** formulation has demonstrated 24 hour residual activity after application to a surface, and requires no rinse after application, saving time and money. And this SDC disinfectant and sanitizer formulation is classified in the US EPA's lowest toxicity category, **Category IV**. A Category IV rating by the US EPA means the Agency considers this formulation relatively non-toxic and they do not require any signal word or precautionary statements on the product label. Compare this to other disinfectants and sanitizers on the market that in their concentrated forms and some in their Ready to Use concentrations are rated as Category I or II with Danger or Warning statements, SDC represents a new generation of microbial control.

Advantages of SDC include:

- Powerful broad spectrum protection as a disinfectant, fungicide and virucide
- Faster kill times (kills germs in 30 seconds)
- Provides residual protection for 24 hours
- Effective against resistant bacteria such as MRSA and VRE
- Lowest toxicity rating available
- Labeled for use in diverse environments including restaurants, homes, medical facilities, institutions, day care facilities and on children's toys and play areas
- Does not induce bacterial resistance
- Formulates well with other products
- Stable in solution
- Tasteless, odorless, and colorless
- Non-corrosive, non-flammable
- Doesn't stain or bleach fabric

Table 1: SDC-based Axen-30 has unparalleled efficacy and low toxicity

Unparalleled Efficacy		
Category	**PURE Hard Surface™**	**Leading Brands**
Active Ingredient	**Silver dihydrogen citrate**	**Ethanol/Ammonium Chloride**
EPA Safety Category	IV	II
Standard Bacteria Kill Time	30 sec	10 min
Resistant Bacteria Kill Time	2 min	None
Fungal/Virus Kill Time	10 min	10 min
Residual Protection	24 hour	None
Rinse Required	No	Yes
Irritating Fumes	No	Yes
Skin Irritation	No	Yes
Flammable	No	Yes

Table 2: SDC's strong efficacy against microbes

	MIC of SDC	MBC of SDC
Microorganism	**%SDC (ppm Ag+)**	**%SDC (ppm Ag+)**
Corynebacterium xerosis ATCC 373	0.12 (2.88 ppm)	
Corynebacterium minutissimum ATCC 23348	0.12 (2.88 ppm)	0.16 (3.84 ppm)
Propionibacterium acnes ATCC 6919	0.25 (6.00 ppm)	
Staphylococcus aureus ATCC 6538	0.16 (3.84 ppm)	0.31 (7.44 ppm)
Escherichia coli ATCC 10536	0.08 (1.92 ppm)	0.16 (3.84 ppm)
Pseudomonas aeruginosa ATCC 15442	0.16 (3.84 ppm)	0.08 (1.92 ppm)
Candida albicans ATCC 10231	0.12 (2.88 ppm)	>1.25 (30 ppm)
Malassezia furfur DSM 6171	0.25 (6.00 ppm)	
Aspergillus niger ATCC 16404	0.50 (12 ppm)	>2.5 (60 ppm)
Trichophyton mentagrophytes ATCC 9533	0.50 (12 ppm)	0.08 (1.92 ppm)
Klebsiella pneumonia ATCC 4352		0.16 (3.84 ppm)
Epidermophyton floccosum DSM 10709		0.63 (15.12 ppm)

MIC: Minimal Inhibitory Concentrations; MBC: Minimal Bactericidal Concentrations

Table 3: SDC has broad spectrum activity with fast kill times

Axen 30® EPA Registered Disinfection Claims	
Organism	**Kill Time**
Pseudomonas aeruginosa	30 seconds
Staphylococcus aureus	30 seconds
Salmonella choleraesuis	30 seconds
Listeria monocytogenes	30 seconds
Vancomycin resistant *Enterococcus faecium*	2 minutes
Methicillin resistant *Staphylococcus aureus (MRSA)*	2 minutes
***Escherichia coli* 0157:H7**	2 minutes
***Trichophyton mentagrophytes* (Athlete's Foot Fungus)**	10 minutes
HIV type 1- Strain HTLV IIIB	30 seconds
Herpes Simplex Type 1 VR-733 F(1) Strain	1 minute
Influenza A VR-544, Hong Kong strain	10 minutes
Rhinovirus R37 VR-1147, Strain 151-1	10 minutes
Human Coronavirus	3 minutes
Respiratory Syncytial Virus	3 minutes
Adenovirus Type 2	3 minutes
Murine Norovirus	10 minutes
Norovirus	10 minutes
Acinetobacter baumannii	2 minutes
Swine Influenza A (H1N1)	60 seconds
Influenza A (H1N1)	60 seconds
Rotavirus	3 minutes
Campylobacter jejuni	2 minutes
Community Associated Methicillin resistant Staphylococcus aureus (CA□MRSA□PVL)	2 minutes
Community Associated Methicillin resistant Staphylococcus aureus (CA□MRSA)	2 minutes
Avian Influenza A	10 minutes
Polio Type 2, VR-1002, Lansing Strain	10 minutes

PROJECTED INCOME STATEMENT

	2013A (Jul)					2014E (Jul)					2015E (Jul)	2016 (Jul)	2017 (Jul)
$ in million except per share data	Q1A	Q2A	Q3A	Q4A	FYA	Q1A	Q2A	Q3E	Q4E	FYE	FYE	FYE	FYE
Total Revenues	**$0.11**	**$0.26**	**$0.26**	**$0.19**	**$0.82**	**$0.12**	**$0.04**	**$0.15**	**$0.35**	**$0.66**	**$4.50**	**$12.00**	**$22.00**
YOY Growth	*-57.2%*	*19.0%*	*24.6%*	*-52.4%*	*-24.2%*	*4.5%*	*-84.4%*	*-41.9%*	*85.2%*	*-20.0%*	*586.0%*	*166.7%*	*83.3%*
CoGS	0.03	0.06	0.07	0.41	0.57	0.04	0.02	0.04	0.09	0.18	1.01	2.40	4.40
Gross Income	**$0.08**	**$0.21**	**$0.19**	**($0.22)**	**$0.26**	**$0.08**	**$0.02**	**$0.11**	**$0.26**	**$0.48**	**$3.49**	**$9.60**	**$17.60**
Gross Margin	*71.8%*	*78.3%*	*74.0%*	*-116.9%*	*31.1%*	*68.7%*	*51.2%*	*75.0%*	*75.0%*	*72.4%*	*77.5%*	*80.0%*	*80.0%*
R&D	$0.40	$0.41	$0.30	$0.22	$1.33	$0.23	$0.29	$0.30	$0.30	$1.12	$1.25	$1.40	$1.55
% R&D	*359.1%*	*154.4%*	*117.8%*	*116.4%*	*161.6%*	*203.5%*	*704.9%*	*200.0%*	*85.7%*	*171.2%*	*27.8%*	*11.7%*	*7.0%*
SG&A	$1.48	$1.61	$1.46	$1.17	$5.72	$0.99	$1.24	$1.30	$1.40	$4.94	$5.50	$7.50	$9.50
% SG&A	*1341.8%*	*612.2%*	*567.4%*	*618.0%*	*697.3%*	*863.5%*	*3031.7%*	*866.7%*	*400.0%*	*752.4%*	*122.2%*	*62.5%*	*43.2%*
Other	$0.00	$0.00	$0.00	$0.55	$0.55	$2.68	$1.71	$0.00	$0.00	$4.39	$0.00	$0.00	$0.00
% Other	-	-	-	-	-	-	-	-	-	-	-	-	-
Operating Income	**($1.8)**	**($1.8)**	**($1.6)**	**($2.2)**	**($7.3)**	**($3.8)**	**($3.2)**	**($1.5)**	**($1.4)**	**($10.0)**	**($3.3)**	**$0.7**	**$6.6**
Operating Margin	-	-	-	-	-	-	-	-	-	-	-	*5.8%*	*29.8%*
Other Net	($0.4)	($0.0)	$0.0	$0.0	($0.3)	($0.0)	$0.7	$0.0	$0.0	$0.7	$0.0	$0.0	$0.0
Pre-Tax Income	**($2.2)**	**($1.8)**	**($1.6)**	**($2.1)**	**($7.7)**	**($3.8)**	**($2.5)**	**($1.5)**	**($1.4)**	**($9.3)**	**($3.3)**	**$0.7**	**$6.6**
Income taxes(benefit)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Tax Rate	-	-	-	-	-	-	-	-	-	-	-	-	-
Reported Net Income	**($2.2)**	**($1.8)**	**($1.6)**	**($2.1)**	**($7.7)**	**($3.8)**	**($2.5)**	**($1.5)**	**($1.4)**	**($9.3)**	**($3.3)**	**$0.7**	**$6.6**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	-	*835.7%*
Net Margin	-	-	-	-	-	-	-	-	-	-	-	*5.8%*	*29.8%*
Shares Out	*8.7*	*11.0*	*11.3*	*12.4*	*10.8*	*20.7*	*25.0*	*27.1*	*29.0*	*25.4*	*30.0*	*35.0*	*40.0*
Reported EPS	**($0.25)**	**($0.17)**	**($0.14)**	**($0.17)**	**($0.71)**	**($0.19)**	**($0.10)**	**($0.05)**	**($0.05)**	**($0.36)**	**($0.11)**	**$0.02**	**$0.16**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-		
One time charge	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$2.68*	*$1.71*	*$0.00*	*$0.00*	*$4.39*	*$0.00*	*$0.00*	*$0.00*
Non GAAP Net Income	**($2.2)**	**($1.8)**	**($1.6)**	**($2.1)**	**($7.7)**	**($1.2)**	**($0.8)**	**($1.5)**	**($1.4)**	**($4.9)**	**($3.3)**	**$0.7**	**$6.6**
Non GAAP EPS	**($0.25)**	**($0.17)**	**($0.14)**	**($0.17)**	**($0.71)**	**($0.06)**	**($0.03)**	**($0.05)**	**($0.05)**	**($0.19)**	**($0.11)**	**$0.02**	**$0.16**

Source: Company filing and Zacks estimates

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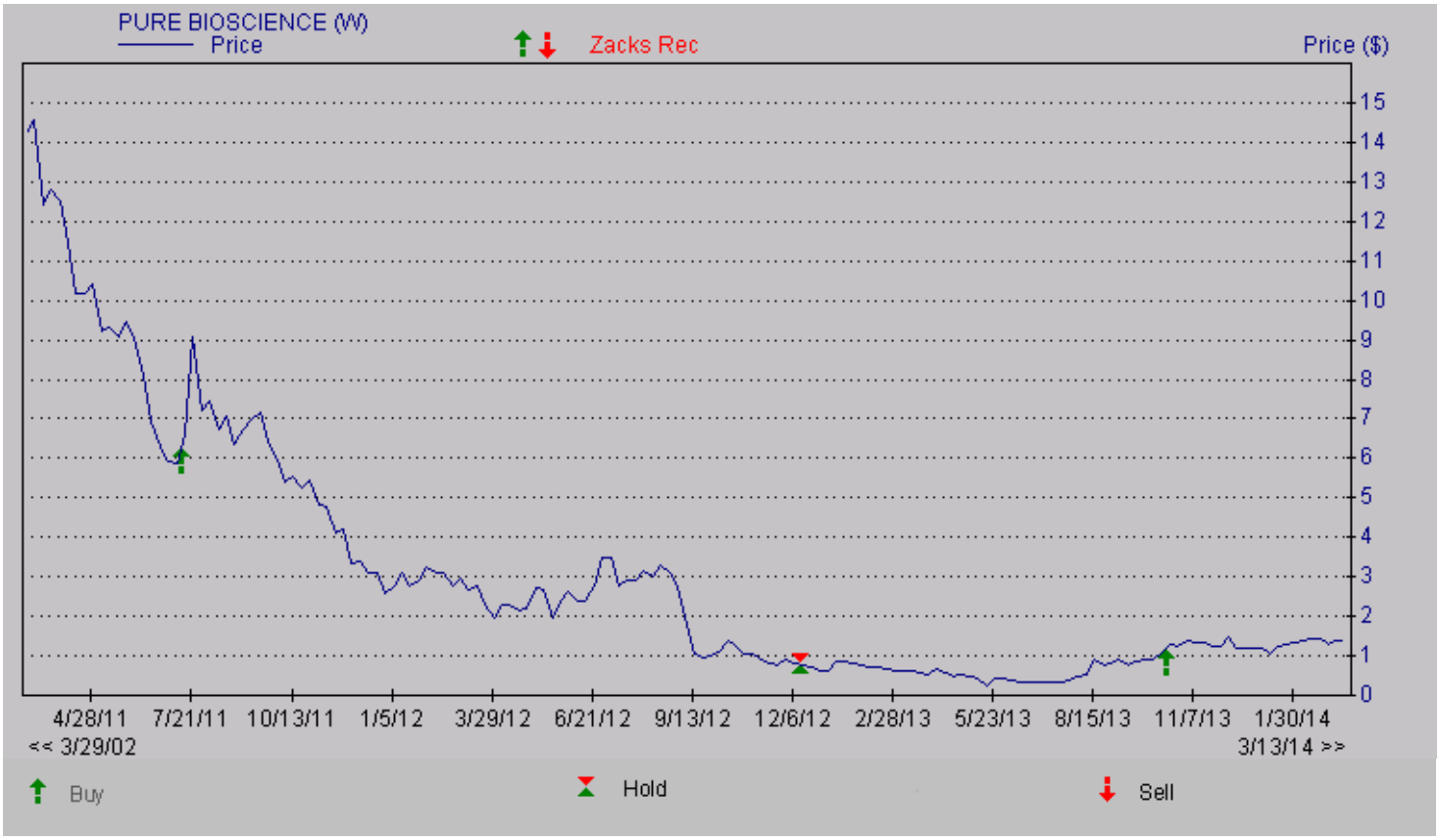

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