Zacks Small-Cap Research

March 5, 2015
Grant Zeng, CFA
312-265-9466
gzeng@zacks.com

scr.zacks.com
10 S. Riverside Plaza, Chicago, IL 60606

Pure Bioscience, Inc. (PURE-OTC)

PURE: Strong financials reported for fiscal 2Q15, Balance sheet remains strong, strong revenue growth is still expected in fiscal 2015 and beyond—maintaining Outperform

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	10/16/2013
Current Price (03/04/15)	$0.62
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 accelerate in fiscal 2015. We maintain Outperform rating for PURE shares.

SUMMARY DATA

52-Week High	**$1.42**
52-Week Low	**$0.54**
One-Year Return (%)	**-54.41**
Beta	**0.67**
Average Daily Volume (sh)	**28,609**
Shares Outstanding (mil)	**40**
Market Capitalization ($mil)	**$25**
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)
2014	0.12 A	0.04 A	0.26 A	0.13 A	0.55 A
2015	0.12 A	0.27 A	0.35 E	0.50 E	1.24 E
2016					4.50 E
2017					12.50 E

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

	Q1 (Oct)	Q2 (Jan)	Q3 (Apr)	Q4 (Jul)	Year (Jul)
2014	-$0.06 A	-$0.03 A	-$0.07 A	-$0.09 A	-$0.26 A
2015	-$0.05 A	-$0.04 A	-$0.04 E	-$0.04 E	-$0.18 E
2016					-$0.09 E
					-$0.01 E

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

© Copyright 2015, Zacks Investment Research. All Rights Reserved.

WHAT'S NEW

- PURE reports strong fiscal second quarter of 2015 financials with a strong balance sheet;
- FCN withdrawal has only limited impact on short term revenue growth;
- Strong momentum on business development and operations;
- We expect strong revenue growth in fiscal 2015 and beyond;
- Maintain Outperform rating and reiterate our 12-month target price of $3.00;

PURE Reports Strong Fiscal Second Quarter Financial Results of 2015

Revenues for the fiscal 2Q15 ended Jan 31, 2015 were $273,000, compared to $41,000 for the fiscal 2Q14, a 566% increase and compared to $117,000 for fiscal 1Q15, a 133% sequential increase.

The fiscal 2Q15 revenue of $273,000 also beat our estimate of $200,000.

R&D expenses were $215,000 for fiscal 2Q15, compared to $289,000 for the fiscal 2Q14.

SG&A expenses were $1.243 million for fiscal 2Q15, compared to $1.61 million for fiscal 2Q14.

Total operating costs and expenses, excluding cost of goods sold, share-based compensation, other share-based expenses, and restructuring costs, for the second fiscal quarter of 2015 and 2014, were $1.4 million and $1.5 million, respectively.

Net loss for fiscal 2Q15 was $1.7 million ($0.04 per share), compared with $2.5 million ($0.10 per share) for fiscal 2Q14.

Adjusted net loss for fiscal 2Q15 and 2Q14 was $1.3 million and $1.5 million, respectively.

Balance Sheet Cleaned and Boosted

As of January 31, 2015, cash and cash equivalents was $3.9 million. There was no long-term debt sitting on the balance sheet.

In August, 2014, PURE raised $7.9 million in an equity placement (includes $4 million from strategic investor Franchise Brands, LLC, created by the founders of SUBWAY® Restaurants).

This new financing provided adequate capital to fund operations for at least the next twelve months enabling the Company to focus on commercialization and revenue generation. This new financing will also help position PURE to pursue its stated objective of up-listing to a national exchange.

During the fiscal 2Q14, PURE extinguished early a promissory note of $1.125 million in principal and other accrued costs for approximately $500,000. As a consequence, the Company has **no long-term debt** now.

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.

Update on Business Development and Operations

PURE continues to make progress in **three business segments**.

Food Processors/Manufacturers

The company is actively evaluating and/or testing in more than 20 companies, and is initiating discussions with other established distributors in this market.

In February, 2015, PURE signed a non-exclusive agreement with **All American Chemical Company Inc.** to distribute PURE® Hard Surface disinfectant to its network of more than 175 food and beverage manufacturers/processors.

All American has placed initial orders and has begun testing at a national brand customer's manufacturing plant.

Another leading **pet food manufacturer** is now using PURE Hard Surface in two plants on a pilot basis. The company currently anticipates an expansion of that test and also an introduction to several of that processor's contract manufacturers/co-packers.

PURE is also developing protocols to begin testing for use in **two national meat processors**.

Restaurants

PURE Hard Surface has been validated by SUBWAY® Restaurants, and the product has recently been approved for use in SUBWAY®'s nearly 27,000 franchised stores in the US.

A phased national rollout out sales plan was launched and initial sales orders began in 2Q15 for SUBWAY® Restaurants U.S. stores.

In addition to Subway, PURE is expanding its reach into other quick service restaurants (QSRs) and casual dining restaurants.

Currently, PURE is working with the parent company of a more than 1,600 unit casual dining chain -- and has recently received positive test results in two stores. PURE Hard Surface disinfectant achieved a 93% greater reduction of bacteria than the current sanitizer in testing on 21 different high touch and food contact surfaces.

The company is developing test protocols for the US operations of another international casual dining restaurant chain with more than 1,600 restaurants.

Evaluation with additional casual dining and QSR chains is on-going.

Cruise Lines

In Feb 2015, PURE and **Intercon Chemical Company**, the exclusively licensed manufacturer of SDC-based products, made a "by invitation only" joint scientific presentation to the attendees of the Cruise Lines International Association's (CLIA) GI Illness Technology Conference.

Attendees of the technology conference were GI Illness task force representatives of the top 10 cruise lines. The joint presentation about the science behind, and the benefits of, PURE's SDC antimicrobial and PURE Hard Surface disinfectant highlighted dramatic SDC test results to prevent and combat Norovirus and other pathogens.

The two companies are evaluating and testing PURE Hard Surface disinfectant by a major international cruise line.

This new business segment is an important technology validation of SDC. Also, PURE could derive modest **royalty income** from sales made by Intercon to the cruise line industry.

Update on Direct Food Contact Processing Aid

Background Information

In Nov 2015, PURE withdrew the Food Contact Notification (FCN) it submitted to the FDA in July 2014 for the use of SDC in raw poultry processing and in January 2015, the company withdrew its FCN to the FDA for produce processing.

The withdrawal is based on a deficiency letter the company received from the FDA stating that the agency has developed new data that is currently under review. That data calls into question the long established safety levels of the cumulative dietary intake of silver in the US resulting from the food contact uses the agency had previously approved. As a result, the FDA indicated that it would not approve PURE's FCN absent new data or additional information that adequately addresses its new toxicity concerns. The FDA has not yet publically released this new data.

FCN Withdrawal Has only Limited Impact on Short Term Revenue Growth

PURE has an on-going communications with FDA to determine additional data needed for FCN re-submission.

Going forward, PURE intends to work with the FDA and the food processing industry to collect or develop the additional data and information necessary to address the FDA's current safety concerns. But the Company cannot provide an exact timeline of when it will be able to resubmit an FCN for the use of SDC as a **direct food contact** processing aid for treating raw poultry and for produce processing.

While waiting more information and direction from the FDA, PURE is actively testing and gathering data to support the FCN resubmissions.

This is a surprise and a disappointment to us as we expect the use of SDC as a direct food contact poultry processing aid will generate revenue for the Company in calendar 4Q14. But the impact on revenue growth is limited only for the short term in our view. Longer term, revenue growth will still be strong even without the use of SDC for food processing.

We Expect Strong Revenue Growth in Fiscal 2015 and Beyond

PURE is now active in three market segments -- Restaurants (testing and sales), food manufacturing/processing (testing and sales), and cruise lines (testing). Management has set the calendar 2015 goals:

- Secure customer adoption in food safety with 2+ national restaurant chains and 10+ national food processors;
- Leverage outsourcing of operations and supply chain;
- Provide incremental cost savings and increase production scale;
- Subject to updated new guidelines from the FDA, submit and secure FDA and USDA authorization for use of SDC as a direct food contact/processing aid for poultry, produce, beef and pork;
- License PURE distribution and SDC applications to non-core markets; and
- Seek up-listing to a national stock exchange.

Based on the Company’s current marketing plan and recent developments, **we expect** that strong revenue growth will be achieved in calendar 2015 and beyond.

We remind investors that PURE recently completed the restructuring, and is reborn as a new company with refocused strategy on food safety. 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**.

During the second half of fiscal 2014, the new management team generated significant momentum in advancing its business strategy to commercialize its SDC-based technology as a food safety solution. PURE extended commercial market test launch of PURE® Hard Surface Disinfectant to over 650 Subway stores and is selling this product in all of its 27,000 stores. Customer feedback on both SDC product performance and ease of use are very positive. The phased U.S. national rollout is under way.

With new management and new strategy, we believe revenue will grow significantly in fiscal 2015 and beyond. Specifically, we estimate total revenue for fiscal 2015 will reach $1.24 million, representing an increase of 126% over fiscal 2014. The Company will become profitable in fiscal 2018 based on total revenue of $22.5 million according to our financial model. Earnings per share will reach $0.24 by fiscal 2020 based on revenue of $38.5 million.

PURE Shares Are Undervalued

We maintain our Outperform rating on PURE shares and reiterate our 12-month price target of $3.00 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 $0.65 per share with a market cap of $26 million based on 40 million shares outstanding. We think this is a deep discount based on the company's fundamentals. According to our model, revenue will grow at 99% CAGR in the next fiscal 5 years. PURE will become profitable in fiscal 2018 with an EPS of 0.10 based on total revenue of $22.5 million. EPS will grow to $0.24 per share in fiscal 2020 based on total revenue of $38.5 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 $0.24 per share in fiscal 2020, discounted at 20% for 5 years, we come up with a target price of $3.00. This values PURE at $120 million in market cap, which we think is still conservative.

But 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 provide funding for the next 12 months and the Company may need 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.

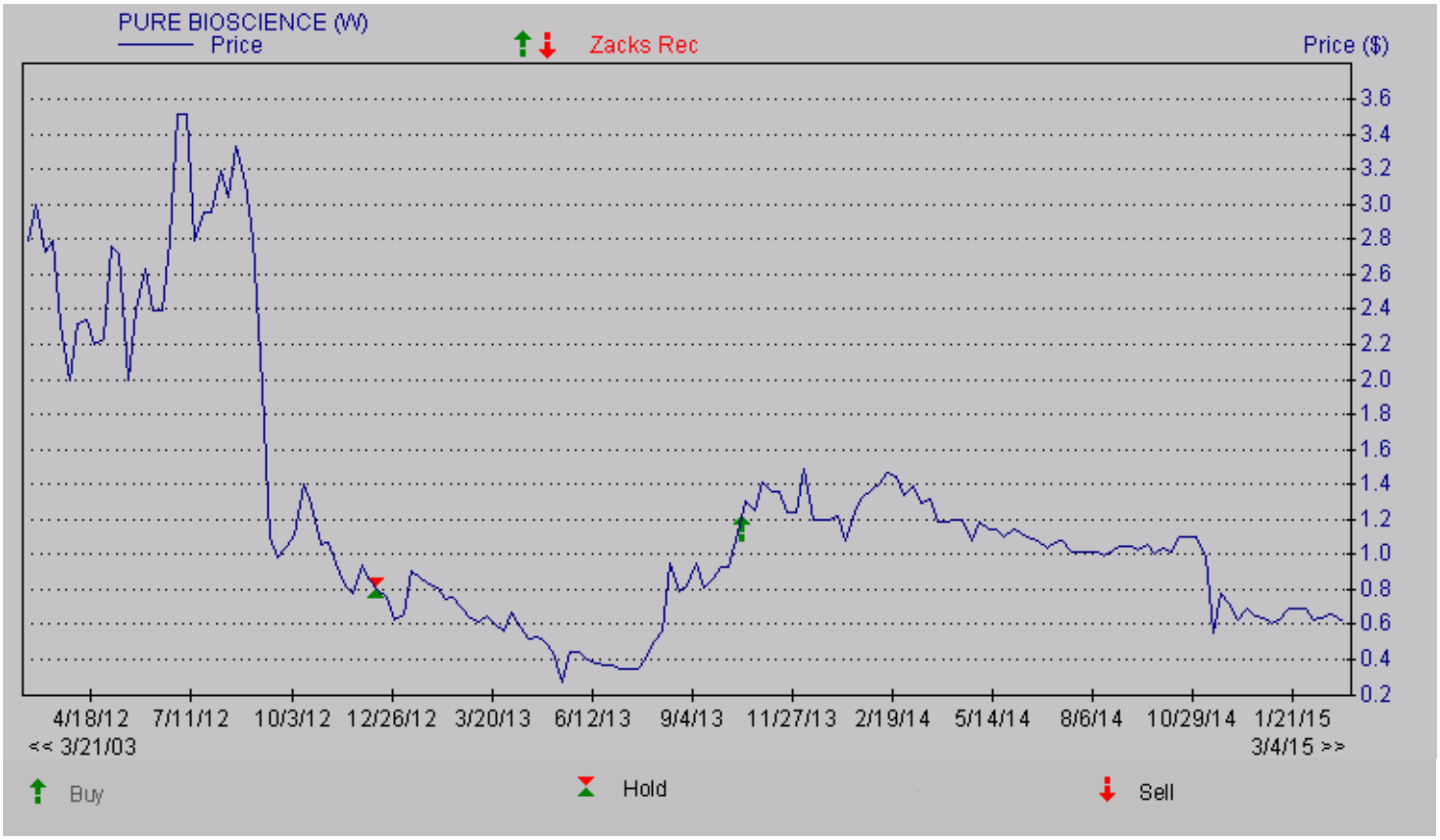
PROJECTED INCOME STATEMENT

	2014A (Jul)					2015E (Jul)					2016 (Jul)	2017 (Jul)	2018 (Jul)	2019 (Jul)	2020 (Jul)
$ in million except per share data	Q1A	Q2A	Q3A	Q4A	FYA	Q1A	Q2A	Q3E	Q4E	FYE	FYE	FYE	FYE	FYE	FYE
Total Revenues	**$0.12**	**$0.04**	**$0.26**	**$0.13**	**$0.55**	**$0.12**	**$0.27**	**$0.35**	**$0.50**	**$1.24**	**$4.50**	**$12.50**	**$22.50**	**$30.00**	**$38.50**
YOY Growth	*4.5%*	*-84.4%*	*1.2%*	*-29.6%*	*-32.9%*	*1.7%*	*565.9%*	*34.1%*	*275.9%*	*125.5%*	*262.9%*	*177.8%*	*80.0%*	*33.3%*	*28.3%*
CoGS	0.04	0.02	0.09	0.20	0.34	0.05	0.11	0.11	0.15	0.37	0.90	2.50	4.50	6.00	7.70
Gross Income	**$0.08**	**$0.02**	**$0.17**	**($0.07)**	**$0.21**	**$0.07**	**$0.16**	**$0.25**	**$0.35**	**$0.87**	**$3.60**	**$10.00**	**$18.00**	**$24.00**	**$30.80**
Gross Margin	*68.7%*	*51.2%*	*65.9%*	*-49.6%*	*37.5%*	*61.5%*	*59.3%*	*70.0%*	*70.0%*	*70.0%*	*80.0%*	*80.0%*	*80.0%*	*80.0%*	*80.0%*
R&D	$0.23	$0.29	$0.25	$0.26	$1.03	$0.18	$0.22	$0.25	$0.25	$0.89	$1.00	$1.20	$1.30	$1.45	$1.50
% R&D	*203.5%*	*704.9%*	*95.0%*	*196.2%*	*187.6%*	*150.4%*	*78.8%*	*71.4%*	*50.0%*	*71.9%*	*22.2%*	*9.6%*	*5.8%*	*4.8%*	*3.9%*
SG&A	$0.99	$1.24	$1.34	$1.48	$5.06	$1.19	$1.20	$1.35	$1.40	$5.14	$6.50	$9.50	$11.00	$12.50	$13.50
% SG&A	*863.5%*	*3031.7%*	*512.6%*	*1114.3%*	*919.3%*	*1018.8%*	*439.9%*	*385.7%*	*280.0%*	*414.8%*	*144.4%*	*76.0%*	*48.9%*	*41.7%*	*35.1%*
Other	$2.68	$1.71	$0.77	$0.86	$6.02	$0.63	$0.48	$0.50	$0.50	$2.12	$0.00	$0.00	$0.00	$0.00	$0.00
% Other	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Operating Income	**($3.8)**	**($3.2)**	**($2.2)**	**($2.7)**	**($11.9)**	**($1.9)**	**($1.7)**	**($1.9)**	**($1.8)**	**($7.3)**	**($3.9)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
Operating Margin	-	-	-	-	-	-	-	-	-	-	*-86.7%*	*-5.6%*	*25.3%*	*33.5%*	*41.0%*
Other Net	($0.0)	$0.7	$0.1	($0.0)	$0.9	($0.0)	$0.0	$0.0	$0.0	($0.0)	$0.0	$0.0	$0.0	$0.0	$0.0
Pre-Tax Income	**($3.8)**	**($2.5)**	**($2.0)**	**($2.7)**	**($11.1)**	**($1.9)**	**($1.7)**	**($1.9)**	**($1.8)**	**($7.3)**	**($3.9)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
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	$0.0	$0.0
Tax Rate	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Reported Net Income	**($3.8)**	**($2.5)**	**($2.0)**	**($2.7)**	**($11.1)**	**($1.9)**	**($1.7)**	**($1.9)**	**($1.8)**	**($7.3)**	**($3.9)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	*-82.1%*	*-914.3%*	*76.3%*	*57.2%*
Net Margin	-	-	-	-	-	-	-	-	-	-	*-86.7%*	*-5.6%*	*25.3%*	*33.5%*	*41.0%*
Shares Out	*20.7*	*25.0*	*27.9*	*28.9*	*25.6*	*37.0*	*39.9*	*42.0*	*42.5*	*40.3*	*45.0*	*50.0*	*55.0*	*60.0*	*65.0*
Reported EPS	**($0.19)**	**($0.10)**	**($0.07)**	**($0.09)**	**($0.43)**	**($0.05)**	**($0.04)**	**($0.04)**	**($0.04)**	**($0.18)**	**($0.09)**	**($0.01)**	**$0.10**	**$0.17**	**$0.24**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	-	*-840.3%*	*61.6%*	*45.1%*
One time charge	*$2.68*	*$1.71*	*$0.00*	*$0.00*	*$4.39*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*
Non GAAP Net Income	**($1.2)**	**($0.8)**	**($2.0)**	**($2.7)**	**($6.7)**	**($1.9)**	**($1.7)**	**($1.9)**	**($1.8)**	**($7.3)**	**($3.9)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
Non GAAP EPS	**($0.06)**	**($0.03)**	**($0.07)**	**($0.09)**	**($0.26)**	**($0.05)**	**($0.04)**	**($0.04)**	**($0.04)**	**($0.18)**	**($0.09)**	**($0.01)**	**$0.10**	**$0.17**	**$0.24**

Source: Company filing and Zacks estimates

© Copyright 2015, Zacks Investment Research. All Rights Reserved.

HISTORICAL ZACKS RECOMMENDATIONS



DISCLOSURES

The following disclosures relate to relationships between Zacks Small-Cap Research ("Zacks SCR"), a division of Zacks Investment Research ("ZIR"), and the issuers covered by the Zacks SCR Analysts in the Small-Cap Universe.

ANALYST DISCLOSURES

I, Grant Zeng, CFA, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report. I believe the information used for the creation of this report has been obtained from sources I considered to be reliable, but I can neither guarantee nor represent the completeness or accuracy of the information herewith. Such information and the opinions expressed are subject to change without notice.

INVESMENT BANKING, REFERRALS, AND FEES FOR SERVICE

Zacks SCR does not provide nor has received compensation for investment banking services on the securities covered in this report. Zacks SCR does not expect to receive compensation for investment banking services on the Small-Cap Universe. Zacks SCR may seek to provide referrals for a fee to investment banks. Zacks & Co., a separate legal entity from ZIR, is, among others, one of these investment banks. Referrals may include securities and issuers noted in this report. Zacks & Co. may have paid referral fees to Zacks SCR related to some of the securities and issuers noted in this report. From time to time, Zacks SCR pays investment banks, including Zacks & Co., a referral fee for research coverage.

Zacks SCR has received compensation for non-investment banking services on the Small-Cap Universe, and expects to receive additional compensation for non-investment banking services on the Small-Cap Universe, paid by issuers of securities covered by Zacks SCR Analysts. Non-investment banking services include investor relations services and software, financial database analysis, advertising services, brokerage services, advisory services, equity research, investment management, non-deal road shows, and attendance fees for conferences sponsored or co-sponsored by Zacks SCR. The fees for these services vary on a per client basis and are subject to the number of services contracted. Fees typically range between ten thousand and fifty thousand USD per annum.

POLICY DISCLOSURES

© Copyright 2015, Zacks Investment Research. All Rights Reserved.

Zacks SCR Analysts are restricted from holding or trading securities placed on the ZIR, SCR, or Zacks & Co. restricted list, which may include issuers in the Small-Cap Universe. ZIR and Zacks SCR do not make a market in any security nor do they act as dealers in securities. Each Zacks SCR Analyst has full discretion on the rating and price target based on his or her own due diligence. Analysts are paid in part based on the overall profitability of Zacks SCR. Such profitability is derived from a variety of sources and includes payments received from issuers of securities covered by Zacks SCR for services described above. No part of analyst compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in any report or article.

ADDITIONAL INFORMATION

Additional information is available upon request. Zacks SCR reports are based on data obtained from sources we believe to be reliable, but are not guaranteed as to be accurate nor do we purport to be complete. Because of individual objectives, this report should not be construed as advice designed to meet the particular investment needs of any investor. Any opinions expressed by Zacks SCR Analysts are subject to change without notice. Reports are not to be construed as an offer or solicitation of an offer to buy or sell the securities herein mentioned.

ZACKS RATING & RECOMMENDATION

ZIR uses the following rating system for the 1127 companies whose securities it covers, including securities covered by Zacks SCR:
Buy/Outperform: The analyst expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters.
Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters.
Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

The current distribution is as follows: Buy/Outperform- 15.8%, Hold/Neutral- 78.3%, Sell/Underperform – 5.7%. Data is as of midnight on the business day immediately prior to this publication.