Zacks Small-Cap Research

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Pure Bioscience, Inc. (PURE-OTC)

PURE: PURE Control for Produce is launched in calendar 1Q16, strong revenue growth is expected in fiscal 2016 and beyond—maintaining Buy rating

Current Recommendation	**Buy**
Prior Recommendation	Hold
Date of Last Change	10/16/2013
Current Price (03/08/16)	$1.19
Twelve- Month Target Price	**$3.00**

OUTLOOK

PURE develops and markets SDC-based antimicrobial products that provide non-toxic solutions to food safety challenges. SDC is a novel, patented platform technology with superior efficacy and low toxicity and can be used in diverse markets. Current focus is on food safety industry.

With the launch of PURE Control in 1Q16, we expect growth will accelerate in fiscal 2016 and beyond. We maintain Buy rating for PURE shares.

SUMMARY DATA

52-Week High	**$1.50**
52-Week Low	**$0.45**
One-Year Return (%)	**75.00**
Beta	**-0.63**
Average Daily Volume (sh)	**43,608**
Shares Outstanding (mil)	**60**
Market Capitalization ($mil)	**$71**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
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)
2015	0.12 A	0.27 A	0.11 A	0.23 A	0.73 A
2016	0.19 A	0.18 A	0.50 E	1.50 E	2.36 E
2017					7.50 E
2018					20.00 E

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

	Q1 (Oct)	Q2 (Jan)	Q3 (Apr)	Q4 (Jul)	Year (Jul)
2015	-$0.05 A	-$0.04 A	-$0.05 A	-$0.05 A	-$0.19 A
2016	-$0.04 A	-$0.04 A	-$0.03 E	-$0.02 E	-$0.13 E
2017					-$0.08 E
2018					$0.01 E

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

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WHAT'S NEW

Update on Fiscal Second Quarter 2016 Financials

Revenue for the fiscal second quarter ended Jan 31, 2016 was $0.18 million, a 35.5% decline compared to $0.27 million for the same period of 2015. This decrease was mainly due to sales fluctuations within the company's existing legacy customer base.

But revenues from PURE's core business, food safety, continued to gain traction, increasing 185% in the second fiscal quarter of 2016 as compared with the prior year.

R&D expenses for fiscal 2Q16 was $0.24 million, compared t0 $0.22 million for the same period of last year.

SG&A expenses were $1.39 million, compared to $1.20 million for the same period of 2015.

Total operating costs and expenses, excluding cost of goods sold and share-based compensation, for the second fiscal quarter of 2016 and 2015, were $1.6 million and $1.4 million, respectively.

GAAP net loss for the second fiscal quarter 2016 was ($10.9) million ($0.19 per share), compared with ($1.7) million ($0.04 per share) for second fiscal quarter 2015.

Non-GAAP adjusted net loss for second fiscal quarter 2016 was ($2.3) million ($0.04 per share), compared to non-GAAP adjusted net loss of ($1.7) million ($0.04 per share) for the fiscal second fiscal quarter 2015.

Balance Sheet Remains Strong

As of Jan 31, 2016, PURE had a cash balance of $6.7 million with no long term debt.

In October, 2015, PURE closed a $6 million private placement with strategic lead investor Franchise Brands LLC. This is Franchise Brands' second investment in PURE.

In November 2015, PURE completed the second and final closing of a follow-on private placement financing with its existing investors, raising $2 million to support its operations.

These new financings greatly boost the company's balance sheet. More importantly, the transactions further validate the company's SDC technology.

The combined $8 million financing will support the Company's operations and business plan through calendar Q1 2017.

Update on PURE Control Launch

In parallel to its PURE Hard Surface business, PURE is launching its second business segment **PURE Control**-which utilizes the company's lead compound SDC as direct food contact processing aid.

Currently, PURE is targeting three key fields for PURE Control.

Produce (FDA)

In September, 2015, PURE resubmitted a Food Contact Notification (FCN) to the US FDA for Silver Dihydrogen Citrate (SDC) as an online reprocessing (OLR) antimicrobial for produce processing aid.

In November, 2015, the company received an Acknowledgement Letter from the FDA for the FCN for SDC as a spray or dip on processed fruits and vegetables stating that its submission is complete and setting an effective date of **January 7, 2016**.

After the FDA approval, there are no additional USDA or other regulatory approvals required for raw produce processing.

PURE **introduced PURE Control®** at IPPE (International Production & Processing Expo) **in late Jan 2016**. IPPE is the world's largest annual poultry, meat and feed industry event attended by more than 30,000 industry leaders and their suppliers seeking to learn about the latest technological developments in the industry.

PURE will target PURE Control as a food safety solution for a broad range of processed vegetables and fruits that are most frequently associated with pathogen contamination. In its regulatory filing, PURE demonstrated materially significant reductions in Salmonella, Listeria and E. coli in processed fresh produce, as compared with current processing chemicals.

Produce is the leading source of foodborne illness in the US. Given the immediate market need and the proven superior efficacy of SDC, we believe PURE Control can quickly achieve meaningful market penetration among fruit and vegetable processors.

Poultry (FDA)

In June, 2015, PURE resubmitted a Food Contact Notification (FCN) to the US FDA for Silver Dihydrogen Citrate (SDC) as an online reprocessing antimicrobial for raw poultry processing aid.

In September, PURE received an Acknowledgement Letter from the US FDA stating that its FCN for SDC as a raw poultry processing aid is complete and setting an effective date of **December 18, 2015**.

The next step in the regulatory approval process is to obtain USDA approval **(Poultry USDA)**. Accordingly, after its receipt of the Acknowledgement Letter from the FDA, PURE immediately submitted its FCN to the Food Safety and Inspection Service of the USDA to commence the USDA review and approval process. As part of the USDA process, PURE is preparing to conduct in-plant process validation and optimization trials with the authorization of the USDA.

PURE has already identified the plants and partners it will work with and has developed protocols for the trials and is ready to begin the plant trials as soon as the USDA completes its FCN review. The company estimates to conduct the trials in early January 2016. Once initiated, the trials will take about 45 to 50 days to complete. At the completion of the trials, PURE expects the USDA to issue a “Letter of No Objection” and list SDC as an approved on line reprocessing poultry processing aid.

According to this time frame, we estimate the company will be able to launch PURE Control for poultry in **March or early April, 2016.**

Meats (FDA/USDA)

PURE continues its product development efforts for the application of SDC as processing aid/intervention for beef and pork. Pending positive test results, PURE expects to file the FCN for processing raw beef and pork in calendar **Q2 2016**.

Go-To-Market Strategies and Programs Underway

With a goal of being positioned to commercialize and execute immediately upon obtaining regulatory approvals, PURE is proactively engaged in both “push” and “pull” sales and marketing initiatives with

processors, retailers and distributors to prime demand for PURE Control®. Among these are some of the very largest vegetable and fruit processors, grocery and restaurant chains.

A number of leading processors, in both poultry and produce, are already using PURE® Hard Surface disinfectant on plant equipment, and therefore are familiar with the benefits of PURE's superior SDC technology. For this reason, PURE anticipates that it may be able to achieve **accelerated market adoption** with a relatively short sales cycle. Additional market dynamics expected to drive adoption include:

- PURE Control's superior efficacy and dramatically lower toxicity vs. processing aids currently in use, and
- The urgent pressure of increasing regulatory requirements.

Huge Market Opportunity for SDC as a Food Contact Processing Aid

Food contamination, especially by Salmonella, is a global health issue. Salmonella is responsible for an estimated 1.2 million food borne illnesses each year. In testing, the USDA has found that at least 25% of chicken parts in the food supply chain were contaminated with Salmonella.

In order to address the issue, the USDA has initiated a Salmonella Action Plan, which is the top Department priority, aiming to significantly reduce the number of Salmonella-related food borne illnesses in the US. This USDA initiative drives increased scrutiny to poultry inspection and processing practices.

Processing aids or interventions commonly used in the US food industry today are highly toxic chemistries. In addition, pathogens can become increasingly resistant and render current interventions less efficacious. As a result, poultry processors need new, highly effective antimicrobial interventions that can provide a heightened level of control over Salmonella that current interventions are not achieving. The demonstrated ability of SDC to reduce Salmonella to levels below the detection limit (when applied during the on-line reprocessing of raw poultry products) has the potential to play an important role in the solution.

Produce is also a leading source of foodborne illness in the US. The Centers for Disease Control and Prevention (CDC) estimates that produce was responsible for 46% of foodborne illnesses and 23% of foodborne illness-related deaths in the US between 1998 and 2008. Leafy greens were identified as the primary source of foodborne illness.

We believe that SDC is a significant improvement over current processing chemicals and provides important advantages because SDC does not induce bacterial resistance and is:

- More effective in reducing or eliminating pathogens
- Easier to handle and dilute
- Non-corrosive to processing equipment
- Non-toxic - does not create noxious fumes

If approved for food contact processing aid, SDC will have the opportunity to target the $1+ billion-dollar market and command a big chunk of the market share based on its superior efficacy and safety.

The raw poultry market opportunity is estimated to be in excess of $350 million and the processed produce opportunity is estimated to exceed $300 million. PURE's long term goal to capture a significant share, at least 10%, of those markets, which means peak annual sales of at least $65 million alone for the two markets.

The initial customers for SDC will be big players in the food processing market including Tyson, Pilgrim's Pride, Perdue, Foster Farms, Wayne Farms, Koch Foods, Taylor Farms, Ready Pac, Dole, Fresh Express, and F and S Produce.

Given the immediate market need and the proven superior efficacy of SDC against Salmonella, we believe that SDC can achieve significant market penetration upon receipt of FDA and USDA approvals.

We Maintain Our Buy Rating on PURE Shares

We maintain our Buy rating on PURE shares and reiterate our 12-month price target of $3.00 per share.

We are impressed with the recent progress the company has achieved and the positive developments within the company. We think the company's valuation is very attractive at this time.

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**. We believe the planned launch of PURE Control in calendar 1Q16 will greatly accelerate revenue growth in calendar 2016 and beyond.

In terms of valuation, we think PURE shares are undervalued at current market price. Currently, the Company trades around $1.20 per share with a market cap of $72 million based on 60 million shares outstanding. We think this is a deep discount based on the company's fundamentals. According to our model, revenue will grow at 125% CAGR in the next fiscal 5 years. PURE will become profitable in fiscal 2018 with an EPS of 0.01 based on total revenue of $20.0 million. EPS will grow to $0.21 per share in fiscal 2020 based on total revenue of $42.5 million. With this in mind, we think PURE shares should be traded at a P/E ratio of 35 x. Applying this P/E multiple with our estimated EPS of $0.21 per share in fiscal 2020, discounted at 25% for 4 years, we come up with a target price of $3.00. This values PURE at $180 million in market cap, which we think is still conservative.

But keep in mind the risks. We noticed that the company's lead product PURE Hard Surface has been in the market for a few years, but sales so far have not been impressive. This could happen to the company's second product PURE Control. Sales of PURE Control may take longer time to gain traction since PURE is still in its early stage of commercialization of its SDC technology. 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 PURE Control may take longer time.

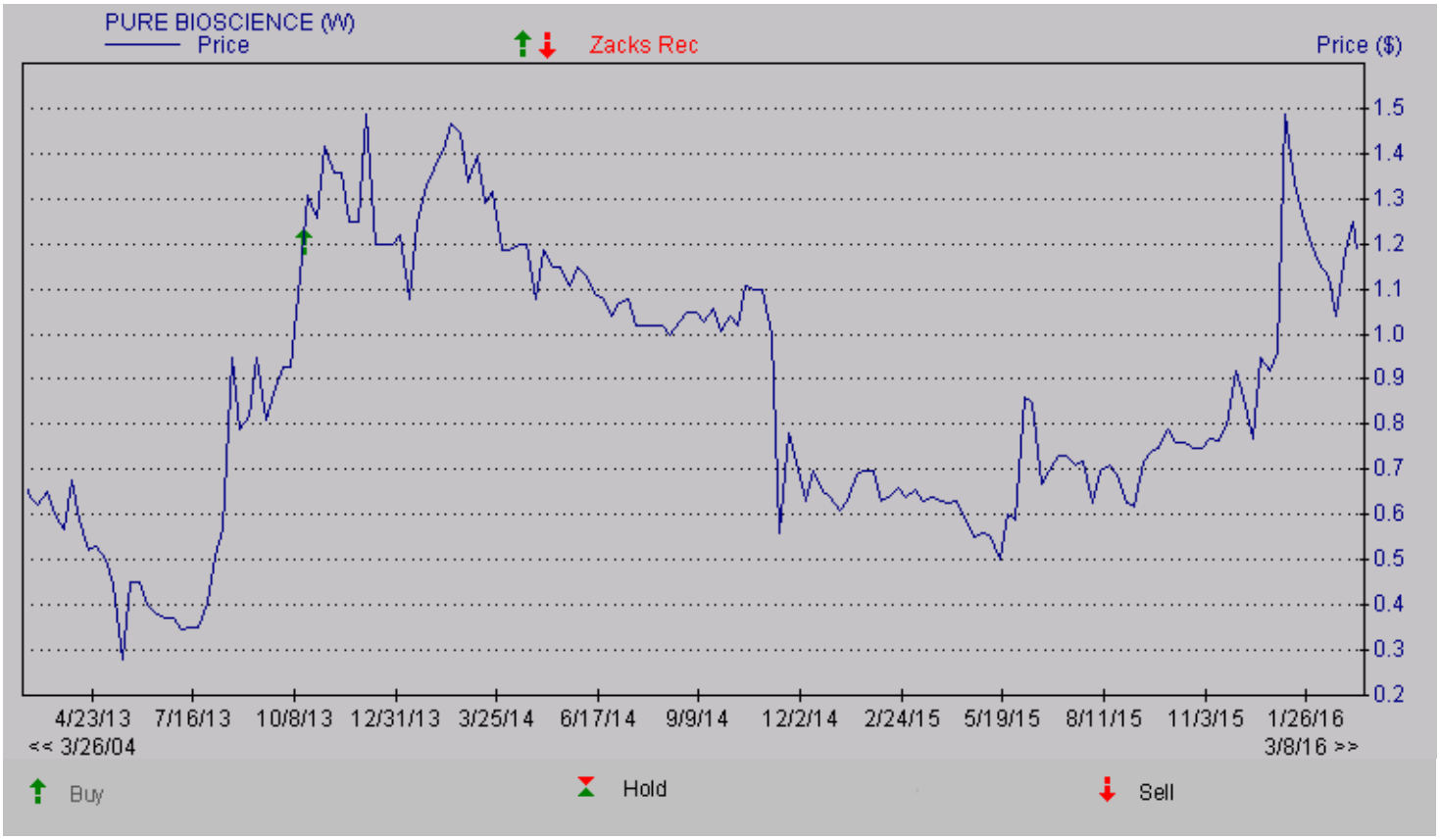
PROJECTED INCOME STATEMENT

	2015A (Jul)					2016 (Jul)					2017 (Jul)	2018 (Jul)	2019 (Jul)	2020 (Jul)
$ in million except per share data	Q1A	Q2A	Q3A	Q4A	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE	FYE
Total Revenues	**$0.12**	**$0.27**	**$0.11**	**$0.23**	**$0.73**	**$0.19**	**$0.18**	**$0.50**	**$1.50**	**$2.36**	**$7.50**	**$20.00**	**$30.00**	**$42.50**
YOY Growth	*1.7%*	*565.9%*	*-58.2%*	*72.9%*	*32.5%*	*59.0%*	*-35.5%*	*358.7%*	*552.2%*	*224.0%*	*217.5%*	*166.7%*	*50.0%*	*41.7%*
CoGS	0.05	0.11	0.07	0.06	0.29	0.05	0.05	0.19	0.57	0.86	1.50	4.00	6.00	8.50
Gross Income	**$0.07**	**$0.16**	**$0.04**	**$0.17**	**$0.44**	**$0.13**	**$0.13**	**$0.31**	**$0.93**	**$1.50**	**$6.00**	**$16.00**	**$24.00**	**$34.00**
Gross Margin	*61.5%*	*59.3%*	*40.4%*	*72.2%*	*60.9%*	*71.0%*	*72.7%*	*62.0%*	*62.0%*	*63.5%*	*80.0%*	*80.0%*	*80.0%*	*80.0%*
R&D	$0.18	$0.22	$0.17	$0.23	$0.79	$0.24	$0.24	$0.25	$0.26	$0.98	$1.20	$1.30	$1.45	$1.50
% R&D	*150.4%*	*78.8%*	*156.9%*	*99.1%*	*108.4%*	*126.9%*	*135.2%*	*50.0%*	*17.3%*	*41.7%*	*16.0%*	*6.5%*	*4.8%*	*3.5%*
SG&A	$1.19	$1.20	$1.21	$1.31	$4.91	$1.09	$1.39	$1.40	$1.60	$5.47	$7.50	$11.00	$12.50	$13.50
% SG&A	*1018.8%*	*439.9%*	*1107.3%*	*570.4%*	*673.8%*	*583.9%*	*787.5%*	*280.0%*	*106.7%*	*231.7%*	*100.0%*	*55.0%*	*41.7%*	*31.8%*
Other	$0.63	$0.48	$0.77	$0.50	$2.38	$0.67	$0.76	$0.50	$0.50	$2.44	$2.50	$3.00	$3.50	$4.00
% Other	*541.9%*	*176.6%*	*702.8%*	*217.4%*	*326.7%*	*361.3%*	*433.5%*	*100.0%*	*33.3%*	*103.1%*	*33.3%*	*15.0%*	*11.7%*	*9.4%*
Operating Income	**($1.9)**	**($1.7)**	**($2.1)**	**($1.9)**	**($7.6)**	**($1.9)**	**($2.3)**	**($1.8)**	**($1.4)**	**($7.4)**	**($5.2)**	**$0.7**	**$6.6**	**$15.0**
Operating Margin	-	-	-	-	-	-	-	-	-	*-312.9%*	*-69.3%*	*3.5%*	*21.8%*	*35.3%*
Other Net	($0.0)	$0.0	$0.0	$0.0	$0.0	($1.0)	($8.6)	$0.0	$0.0	($9.6)	$0.0	$0.0	$0.0	$0.0
Pre-Tax Income	**($1.9)**	**($1.7)**	**($2.1)**	**($1.9)**	**($7.6)**	**($2.8)**	**($10.9)**	**($1.8)**	**($1.4)**	**($17.0)**	**($5.2)**	**$0.7**	**$6.6**	**$15.0**
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
Tax Rate	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Reported Net Income	**($1.9)**	**($1.7)**	**($2.1)**	**($1.9)**	**($7.6)**	**($2.8)**	**($10.9)**	**($1.8)**	**($1.4)**	**($17.0)**	**($5.2)**	**$0.7**	**$6.6**	**$15.0**
YOY Growth	-	-	-	-	-	-	-	-	-	-	*-69.4%*	*-113.5%*	*835.7%*	*129.0%*
Net Margin	-	-	-	-	-	-	-	-	-	-	-	*3.5%*	*21.8%*	*35.3%*
Shares Out	*37.0*	*39.9*	*40.8*	*41.3*	*39.7*	*43.0*	*58.7*	*60.1*	*60.2*	*55.5*	*65.0*	*68.0*	*70.0*	*72.0*
Reported EPS	**($0.05)**	**($0.04)**	**($0.05)**	**($0.05)**	**($0.19)**	**($0.07)**	**($0.19)**	**($0.03)**	**($0.02)**	**($0.31)**	**($0.08)**	**$0.01**	**$0.09**	**$0.21**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	*-112.9%*	*809.0%*	*122.6%*
One time charge	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.96*	*$8.64*	*$0.00*	*$0.00*	*$9.60*	*$0.00*	*$0.00*	*$0.00*	*$0.00*
Non GAAP Net Income	**($1.9)**	**($1.7)**	**($2.1)**	**($1.9)**	**($7.6)**	**($1.9)**	**($2.3)**	**($1.8)**	**($1.4)**	**($7.4)**	**($5.2)**	**$0.7**	**$6.6**	**$15.0**
Non GAAP EPS	**($0.05)**	**($0.04)**	**($0.05)**	**($0.05)**	**($0.19)**	**($0.04)**	**($0.04)**	**($0.03)**	**($0.02)**	**($0.13)**	**($0.08)**	**$0.01**	**$0.09**	**$0.21**

Source: Company filing and Zacks estimates

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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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