Zacks Small-Cap Research

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Pure Bioscience, Inc. (PURE-OTC)

PURE: Withdrawal of FCN has only limited short term impact on revenue growth; strong revenue growth is still expected in fiscal 2015 and beyond, a reborn company with new focus on food safety—maintaining Outperform

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	10/16/2013
Current Price (11/18/14)	$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	**$1.49**
52-Week Low	**$0.55**
One-Year Return (%)	**-52.31**
Beta	**0.89**
Average Daily Volume (sh)	**77,940**
Shares Outstanding (mil)	**40**
Market Capitalization ($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	0.30 E	0.35 E	0.45 E	0.55 E	1.65 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	-$0.06 E	-$0.05 E	-$0.05 E	-$0.05 E	-$0.20 E
2016					-$0.11 E
					-$0.01 E

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

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WHAT'S NEW

- FCN withdrawal has only limited impact on short term revenue growth;
- We expect strong revenue growth in fiscal 2015 and beyond;
- Sales plan to Subway execution is ongoing;
- One year after restructuring, business is bound to take off;
- Balance sheet boosted with recent financing;
- Maintain Outperform rating and reiterate our 12-month target price of $3.00;

FCN Withdrawal Has only Limited Impact on Short Term Revenue Growth

On Nov 10, PURE announced that it has withdrawn the Food Contact Notification (FCN) it submitted to the FDA in July 2014 for the use of SDC in raw poultry 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.

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.

PURE intends to similarly withdraw an FCN for the use of SDC in the processing of produce if it receives a similar deficiency letter from the FDA.

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.

As such, we lowered our revenue estimates for fiscal 2015 from previous $2.05 million to $1.65 million. Revenue estimates beyond fiscal 2015 are also adjusted for the reason.

But we maintain our Outperform rating and reiterate our PT of $3.00 per share.

We Expect Strong Revenue Growth in Fiscal 2015 and Beyond

Revenue for the fiscal 4Q14 ended July 31, 2014 was $133,000, compared with revenue of $189,000 for the fourth fiscal quarter of 2013.

Operating expenses, excluding share-based compensation and restructuring costs, for the fourth fiscal quarter of 2014 and 2013, were $2.0 million and $1.7 million, respectively.

For fiscal year ended July 31, 2014, total revenue was $550,000, compared with $820,000 for the fiscal year ended July 31, 2013.

Total operating expenses, excluding share-based compensation and restructuring costs, were $6.4 million, and $7.4 million, respectively, a reduction of 14%.

The Fiscal 2014 net loss was $11.1 million compared with $7.7 million for Fiscal 2013.

Non-GAAP pro forma net loss for Fiscal 2014 and 2013 was $4.3 million and $6.4 million, respectively.

According to management, as the Company continues to build on the early successes of its new business strategy, it intends to accelerate and expand sales and distribution for its products into the food industry with a focus on a **dual track of food safety market** opportunities:

- Commercialize the current EPA registered PURE® Hard Surface **disinfectant and sanitizer** for use in food service operations and food manufacturing.
- Subject to receiving both FDA and USDA approval, commercialize the use of SDC as a **food processing** and intervention aid for food processors for treating poultry, produce, beef and pork.

PURE will establish strategic alliances to maximize the commercial potential of its technology platform and develop additional proprietary products and applications; and protect and enhance its intellectual property estate.

In calendar 2015, PURE plans to secure customer adoption of its product in food safety with 2+ national restaurant chains and 5+ national food processors.

Based on the Company's current marketing plan and recent developments, **we expect** that strong revenue growth will be achieved in fiscal 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 will sell 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 development for expected system-wide launch. Rollout plans are in development for wider plant adoption from five national food processors that placed commercial pilot orders.

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 $1.65 million, representing an increase of 200% 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.

Update on Ongoing Sales with SUBWAY(R) Restaurants and Others

Despite the delay in the FDA approval process to commercialize SDC as a direct food contact poultry processing aid, the use of EPA Approved PURE(R) Hard Surface Disinfectant is not affected by the FCN withdrawal.

PURE remains laser focused on its core, primary strategy to commercialize SDC disinfectant for food contact surfaces in restaurants and food processors.

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.

PURE has developed marketing materials and a sales rollout plan and is currently executing the plan. PURE Hard Surface is being presented at a series of meetings of large franchisee groups. The Company is also in active discussions with SUBWAY® for expanded use and additional applications of PURE Hard Surface within the stores.

As a result of progress with SUBWAY®, PURE is in discussions to develop testing protocols with several additional restaurant chains. Also, given the increased industry concern about and focus on Norovirus, the Company is in discussions with restaurant chains who are specifically interested in testing PURE Hard Surface's superior efficacy in killing that virus.

New Distribution Channel for SDC

PURE is developing a new distribution channel for food processing using SDC in food contact surface disinfection. The Company has received initial orders by working with contract cleaning and sanitizing companies whose clients are food processing companies. PURE is in discussions with additional similar companies to broaden and deepen its reach into food processors, positioning SDC as part of a uniquely powerful preventative sanitation program.

The Company expects this new channel will prove to be a means to broaden its sales efforts and increase the number of food processors using its products on a regular basis.

One Year after Restructuring, Business Is Bound to Take Off in Fiscal 2015

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.

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.

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 food service 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.

One year after the execution of the restructuring, PURE has achieved **multiple accomplishments in several business fronts.**

For Quick Service Restaurant (QSR),

- In July 2014, PURE successfully completed the commercial market test launch of PURE® Hard Surface disinfectant in over 650 SUBWAY® Restaurant stores.
- In October, 2014, PURE announced that SUBWAY® Restaurants authorized PURE® Hard Surface disinfectant to be sold for use in all of its 27,000 U.S. stores. Plans in development for phased U.S. national sales rollout.
- During 2013 -2014, first pilot orders from several national food manufacturers and processors to initiate pilot adoption and operating protocol development for various pathogen and hygiene control points in their plants. PURE is developing rollout plans with processors/manufacturers for wider plant adoption.

At the strategic manufacturing & distribution agreement front,

- In December, 2013, PURE out-sourced its manufacturing and supply chain of SDC-based products to and established distribution agreement with Intercon Chemical Company (ICC). This agreement increases PURE's manufacturing capacity for SDC-based products and provides potential future royalty income for SDC-based products sold through ICC's institutional cleaning and sanitation distribution channel.

Balance Sheet Cleaned and Boosted

As of July 31, 2014, PURE had $86,000 in cash and cash equivalents.

In March 2014, PURE raised $1.3 million from the sale of 1.35 million shares of common stock through private equity placements.

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, resulting in a gain on extinguishment of debt of $727,000. As a consequence, as of April 30, 2014, the Company has **no long-term debt**.

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.

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 88% 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

	2014 A (July)					2015E (Jul)					2016 (Jul)	2017 (Jul)	2018 (Jul)	2019 (Jul)	2020 (Jul)
$ in million except per share data	Q1A	Q2A	Q3A	Q4A	FYA	Q1E	Q2E	Q3E	Q4E	FYE	FYE	FYE	FYE	FYE	FYE
Total Revenues	**$0.12**	**$0.04**	**$0.26**	**$0.13**	**$0.55**	**$0.30**	**$0.35**	**$0.45**	**$0.55**	**$1.65**	**$4.50**	**$12.50**	**$22.50**	**$30.00**	**$38.50**
YOY Growth	*4.5%*	*-84.4%*	*1.2%*	*-29.6%*	*-32.9%*	*160.9%*	*753.7%*	*72.4%*	*313.5%*	*200.0%*	*172.7%*	*177.8%*	*80.0%*	*33.3%*	*28.3%*
CoGS	0.04	0.02	0.09	0.20	0.34	0.09	0.11	0.14	0.17	0.50	0.90	2.50	4.50	6.00	7.70
Gross Income	**$0.08**	**$0.02**	**$0.17**	**($0.07)**	**$0.21**	**$0.21**	**$0.25**	**$0.32**	**$0.39**	**$1.16**	**$3.60**	**$10.00**	**$18.00**	**$24.00**	**$30.80**
Gross Margin	*68.7%*	*51.2%*	*65.9%*	*-49.6%*	*37.5%*	*70.0%*	*70.0%*	*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	$0.25	$0.25	$0.25	$0.25	$1.00	$1.15	$1.20	$1.30	$1.45	$1.50
% R&D	*203.5%*	*704.9%*	*95.0%*	*196.2%*	*187.6%*	*83.3%*	*71.4%*	*55.6%*	*45.5%*	*60.6%*	*25.6%*	*9.6%*	*5.8%*	*4.8%*	*3.9%*
SG&A	$0.99	$1.24	$1.34	$1.48	$5.06	$1.45	$1.50	$1.55	$1.60	$6.10	$7.50	$9.50	$11.00	$12.50	$13.50
% SG&A	*863.5%*	*3031.7%*	*512.6%*	*1114.3%*	*919.3%*	*483.3%*	*428.6%*	*344.4%*	*290.9%*	*369.7%*	*166.7%*	*76.0%*	*48.9%*	*41.7%*	*35.1%*
Other	$2.68	$1.71	$0.77	$0.86	$6.02	$0.50	$0.50	$0.50	$0.50	$2.00	$0.00	$0.00	$0.00	$0.00	$0.00
% Other	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Operating Income	**($3.8)**	**($3.2)**	**($2.2)**	**($2.7)**	**($11.9)**	**($2.0)**	**($2.0)**	**($2.0)**	**($2.0)**	**($7.9)**	**($5.1)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
Operating Margin	-	-	-	-	-	-	-	-	-	-	*-112.2%*	*-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)**	**($2.0)**	**($2.0)**	**($2.0)**	**($2.0)**	**($7.9)**	**($5.1)**	**($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)**	**($2.0)**	**($2.0)**	**($2.0)**	**($2.0)**	**($7.9)**	**($5.1)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	*-86.1%*	*-914.3%*	*76.3%*	*57.2%*
Net Margin	-	-	-	-	-	-	-	-	-	-	*-112.2%*	*-5.6%*	*25.3%*	*33.5%*	*41.0%*
Shares Out	*20.7*	*25.0*	*27.9*	*28.9*	*25.6*	*34.7*	*42.0*	*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)**	**($0.06)**	**($0.05)**	**($0.05)**	**($0.05)**	**($0.20)**	**($0.11)**	**($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)**	**($2.0)**	**($2.0)**	**($2.0)**	**($2.0)**	**($7.9)**	**($5.1)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
Non GAAP EPS	**($0.06)**	**($0.03)**	**($0.07)**	**($0.09)**	**($0.26)**	**($0.06)**	**($0.05)**	**($0.05)**	**($0.05)**	**($0.20)**	**($0.11)**	**($0.01)**	**$0.10**	**$0.17**	**$0.24**

Source: Company filing and Zacks estimates

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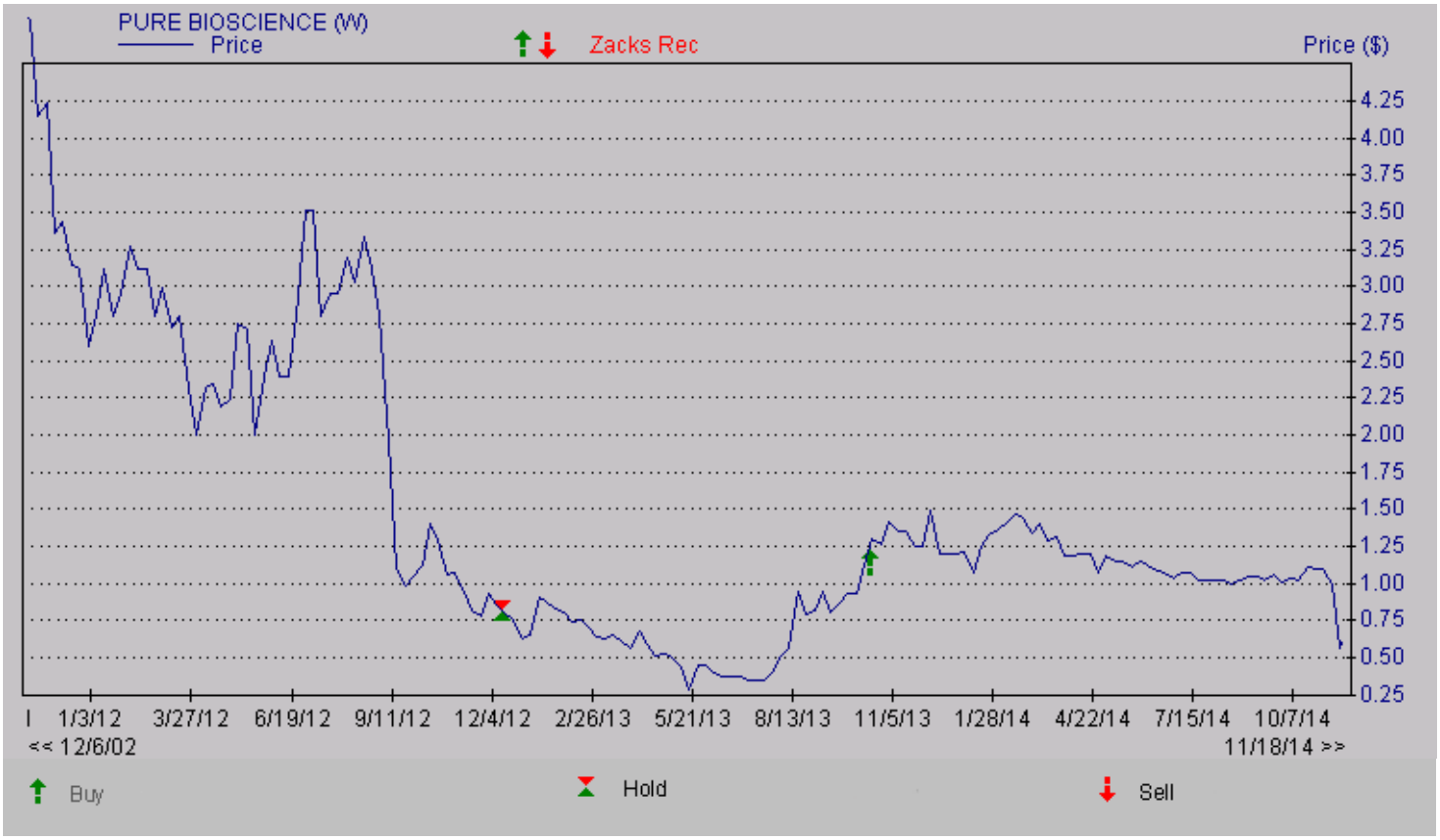

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