Zacks Small-Cap Research

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Pure Bioscience, Inc. (PURE-OTC)

PURE: PURE Control is expected to be 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 (10/28/15)	$0.70
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 2016 and beyond. We maintain Buy rating for PURE shares.

SUMMARY DATA

52-Week High	**$1.18**
52-Week Low	**$0.45**
One-Year Return (%)	**-30.39**
Beta	**0.07**
Average Daily Volume (sh)	**26,846**
Shares Outstanding (mil)	**41**
Market Capitalization ($mil)	**$29**
Short Interest Ratio (days)	**3.92**
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	0.30 E	0.50 E	1.15 E	1.55 E	3.50 E
2017					12.50 E
2018					22.50 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	-$0.05 E	-$0.05 E	-$0.04 E	-$0.04 E	-$0.18 E
2017					-$0.01 E
2018					$0.10 E

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

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WHAT'S NEW

PURE Achieved 33% Increase in Total Revenue in Fiscal 2015

On October 28, PURE reported its financial results for the fiscal year ended July 31, 2015.

Total revenue for the fiscal year ended 2015 were $0.73 million, compared with prior year-end revenues of $0.55 million, an increase of 33%. Subtracting revenue from previous three quarters, we calculated that fourth quarter of 2015 revenue was $0.23 million, representing an increase of 73% over that for the fourth quarter of 2014.

R&D expenses were $0.79 million for fiscal 2015, compared to $1.03 million for fiscal 2014.

SG&A expenses in fiscal 2015 were $4.91 million, compared to $5.06 million in fiscal 2014.

GAAP net loss for fiscal 2015 was $7.6 million ($0.19 per share), compared to a GAAP net loss of $11.1 million ($0.26 per share).

Total operating costs and expenses, excluding cost of goods sold, share-based compensation, other share-based expenses, and restructuring costs, for the fiscal year ended of 2015 and 2014, were $5.7 million and $6.1 million, respectively.

Balance Sheet Boosted by Recent Financing

PURE exited the fiscal year 2015 third quarter with a cash balance of $1.3 million with no long term debt.

On October 26, PURE closed a $6 million private placement with strategic lead investor Franchise Brands LLC. This is Franchise Brands' second investment in PURE.

This new financing greatly boosts the company's balance sheet. More importantly, this transaction further validates the company's SDC technology.

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 Launches Plans for 'PURE Control®

In parallel to its PURE Hard Surface business, PURE is launching plans for 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.

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 2015** (which preserves the timing of PURE's go-to-market commercialization strategy for PURE Control in calendar **Q1 2016**).

The next step in the regulatory approval process is to obtain USDA approval **(Poultry USDA)**. With the receipt of the FDA's Acknowledgement Letter, PURE is now eligible to initiate this next step. 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. 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.

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.

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.

The mandatory 120-day FDA review of PURE's FCN for fresh produce processing is expected to be completed, and the FCN would become effective, in **mid-January**.

There are no additional USDA or other regulatory approvals required for produce and PURE is prepared to begin commercialization of PURE Control for raw produce processing in calendar **Q1 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®.

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 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.

Update on PURE Hard Surface Business

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

Food Processors/Manufacturers

PURE Hard Surface disinfectant is being used in a growing number of food processors/manufacturers. PURE is actively evaluating/testing pilot orders in 45+ companies (up from 35 in last quarter). The company is continuing to build diversified revenue in this channel with over 20 national customers (e.g., poultry, meats, produce, bakery, pet food and tortillas).

Significant interest and adoption has been driven by SDC's documented superior efficacy against *Listeria*, which is a persistent and growing concern among manufacturers.

Pure is continuing to build reach and market penetration through partnering with distributors with established processor customer bases.

Restaurants

Pure is continuing to build market reach into **quick service restaurants** (QSRs) and casual dining restaurant chains.

Pure continued phased U.S. national sales rollout with SUBWAY® Restaurants*(on a market-by-market basis).

- Grew sales effort with SUBWAY development agents/multi-unit operators

- Rolled out to largest franchisees in California and Mid-Atlantic markets. Added two new distribution points in the SUBWAY network; total market reach will be into more than 7,000 stores (25%) in the U.S. system.
- Recent SUBWAY approval for use in ice machines expands in-store application. Additional areas of in-store use also being tested.

Two new customers: One national QSR chain (approx. 3,000 stores) and one national casual dining chain (approx. 150 locations) have placed orders for PURE Hard Surface for use in combatting Norovirus risk in-store. In both instances, this initial order opens the door to expand use and applications in the respective stores.

Pure also continued on-going evaluation with additional casual dining and QSR chains.

Calendar 2016 Goals and Strategy

Pure has mapped out its goals and strategy for calendar 2016. The company will continue to commercialize **PURE Hard Surface** in two market segments (a) food service (testing and sales), and (b) food manufacturing/processing (testing and sales).

The company plans to secure adoption with 5+ national restaurant chains and 30+ national food manufacturers/processors with PURE Hard Surface disinfectant in 2016.

More importantly, Pure plans to launch **PURE Control** as a processing aid for raw poultry and fresh produce in calendar 2016. Immediately upon receipt of respective regulatory approvals for use of SDC as a direct food contact processing aid for raw poultry and fresh produce processing, the company plans to launch PURE Control sales and marketing initiatives (targeting calendar Q1 2016). Long term goal is to capture 10% share of those markets.

Pure will continue to pursue FDA/USDA approvals for use of SDC as a direct food contact processing aid for raw meats.

One more goal is to continue to out-license PURE distribution and SDC applications to non-core markets and receive some royalty revenue from the licensing.

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.

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

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, we think PURE shares are undervalued at current market price. Currently, the Company trades around $0.70 per share with a market cap of $30 million based on 41 million shares outstanding. We think this is a deep discount based on the company's fundamentals. According to our model, revenue will grow at 121% 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 25% for 4 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.

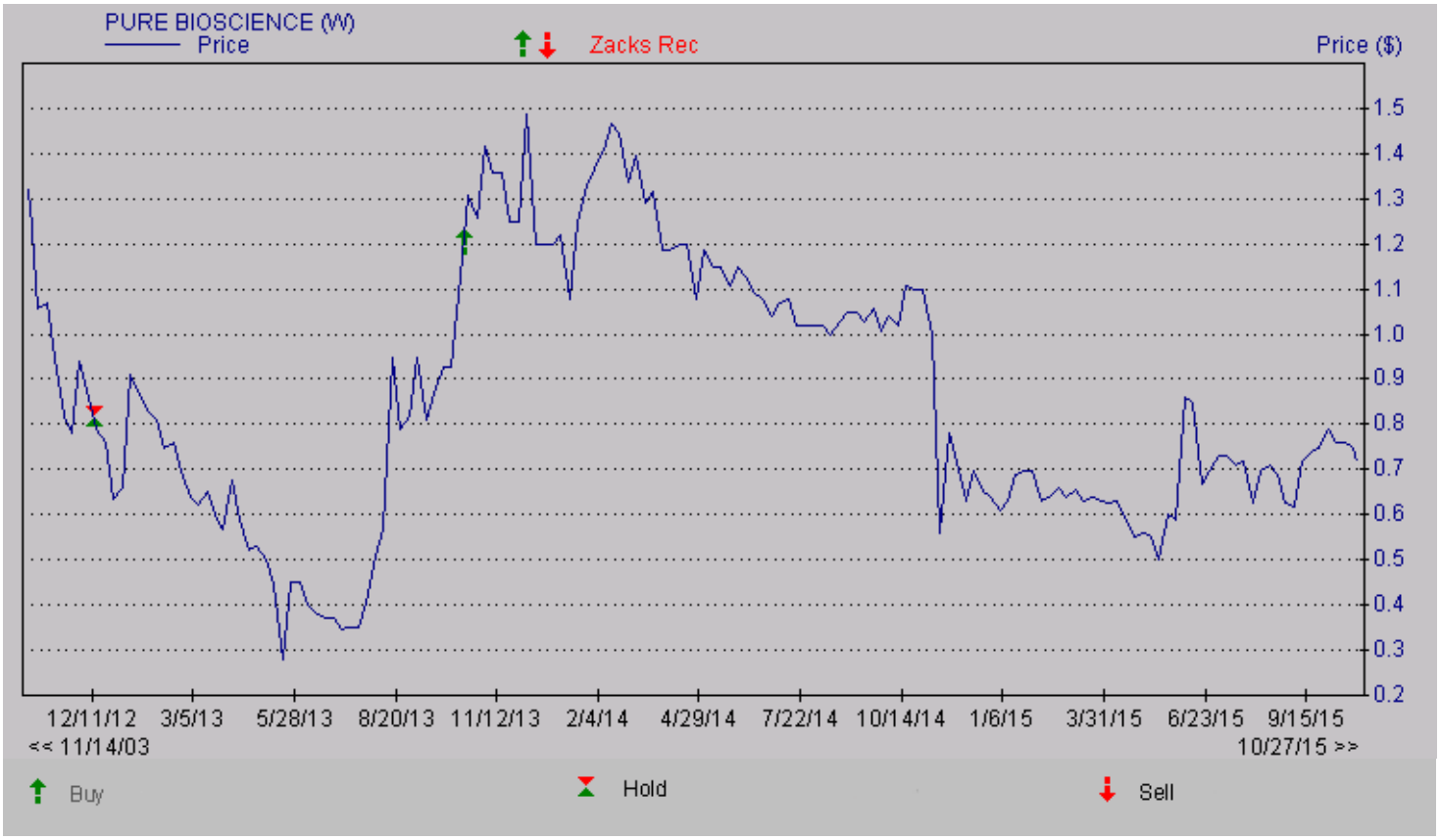
PROJECTED INCOME STATEMENT

	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**	**$0.30**	**$0.50**	**$1.15**	**$1.55**	**$3.50**	**$12.50**	**$22.50**	**$30.00**	**$38.50**
YOY Growth	*1.7%*	*565.9%*	*-58.2%*	*72.9%*	*32.5%*	*156.4%*	*83.2%*	*955.0%*	*573.9%*	*380.1%*	*257.1%*	*80.0%*	*33.3%*	*28.3%*
CoGS	0.05	0.11	0.07	0.06	0.29	0.11	0.19	0.44	0.59	1.33	2.50	4.50	6.00	7.70
Gross Income	**$0.07**	**$0.16**	**$0.04**	**$0.17**	**$0.44**	**$0.19**	**$0.31**	**$0.71**	**$0.96**	**$2.17**	**$10.00**	**$18.00**	**$24.00**	**$30.80**
Gross Margin	*61.5%*	*59.3%*	*40.4%*	*72.2%*	*60.9%*	*62.0%*	*62.0%*	*62.0%*	*62.0%*	*62.0%*	*80.0%*	*80.0%*	*80.0%*	*80.0%*
R&D	$0.18	$0.22	$0.17	$0.23	$0.79	$0.23	$0.25	$0.25	$0.26	$0.99	$1.20	$1.30	$1.45	$1.50
% R&D	*150.4%*	*78.8%*	*156.9%*	*99.1%*	*108.4%*	*76.7%*	*50.0%*	*21.7%*	*16.8%*	*28.3%*	*9.6%*	*5.8%*	*4.8%*	*3.9%*
SG&A	$1.19	$1.20	$1.21	$1.31	$4.91	$1.50	$1.80	$2.00	$2.20	$7.50	$9.50	$11.00	$12.50	$13.50
% SG&A	*1018.8%*	*439.9%*	*1107.3%*	*570.4%*	*673.8%*	*500.0%*	*360.0%*	*173.9%*	*141.9%*	*214.3%*	*76.0%*	*48.9%*	*41.7%*	*35.1%*
Other	$0.63	$0.48	$0.77	$0.50	$2.38	$0.50	$0.50	$0.50	$0.50	$2.00	$0.00	$0.00	$0.00	$0.00
% Other	*541.9%*	*176.6%*	*702.8%*	*217.4%*	*326.7%*	*166.7%*	*100.0%*	*43.5%*	*32.3%*	*57.1%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Operating Income	**($1.9)**	**($1.7)**	**($2.1)**	**($1.9)**	**($7.6)**	**($2.0)**	**($2.2)**	**($2.0)**	**($2.0)**	**($8.3)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
Operating Margin	-	-	-	-	-	-	-	-	-	*-237.7%*	*-5.6%*	*25.3%*	*33.5%*	*41.0%*
Other Net	($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
Pre-Tax Income	**($1.9)**	**($1.7)**	**($2.1)**	**($1.9)**	**($7.6)**	**($2.0)**	**($2.2)**	**($2.0)**	**($2.0)**	**($8.3)**	**($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
Tax Rate	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Reported Net Income	**($1.9)**	**($1.7)**	**($2.1)**	**($1.9)**	**($7.6)**	**($2.0)**	**($2.2)**	**($2.0)**	**($2.0)**	**($8.3)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
YOY Growth	-	-	-	-	-	-	-	-	-	-	*-91.6%*	*-914.3%*	*76.3%*	*57.2%*
Net Margin	-	-	-	-	-	-	-	-	-	-	-	*25.3%*	*33.5%*	*41.0%*
Shares Out	*37.0*	*39.9*	*40.8*	*41.3*	*39.7*	*43.0*	*45.0*	*48.0*	*50.0*	*46.5*	*52.0*	*55.0*	*60.0*	*65.0*
Reported EPS	**($0.05)**	**($0.04)**	**($0.05)**	**($0.05)**	**($0.19)**	**($0.05)**	**($0.05)**	**($0.04)**	**($0.04)**	**($0.18)**	**($0.01)**	**$0.10**	**$0.17**	**$0.24**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	*-869.9%*	*61.6%*	*45.1%*
One time charge	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*
Non GAAP Net Income	**($1.9)**	**($1.7)**	**($2.1)**	**($1.9)**	**($7.6)**	**($2.0)**	**($2.2)**	**($2.0)**	**($2.0)**	**($8.3)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
Non GAAP EPS	**($0.05)**	**($0.04)**	**($0.05)**	**($0.05)**	**($0.19)**	**($0.05)**	**($0.05)**	**($0.04)**	**($0.04)**	**($0.18)**	**($0.01)**	**$0.10**	**$0.17**	**$0.24**

Source: Company filing and Zacks estimates

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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.

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