Zacks Small-Cap Research

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Pure Bioscience, Inc. (PURE-OTC)

PURE: FCN will be resubmitted soon, strong revenue growth is expected in fiscal 2015 and beyond—maintaining Buy rating

Current Recommendation	**Buy**
Prior Recommendation	Neutral
Date of Last Change	10/16/2013
Current Price (06/11/15)	$0.85
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 and beyond. We maintain Buy rating for PURE shares.

SUMMARY DATA

52-Week High	**$1.18**
52-Week Low	**$0.45**
One-Year Return (%)	**-25.91**
Beta	**0.79**
Average Daily Volume (sh)	**51,427**
Shares Outstanding (mil)	**41**
Market Capitalization ($mil)	**$33**
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)
2014	0.12 A	0.04 A	0.26 A	0.13 A	0.55 A
2015	0.12 A	0.27 A	0.11 A	0.30 E	0.80 E
2016					3.50 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	-$0.05 A	-$0.04 E	-$0.18 E
2016					-$0.10 E
					-$0.01 E

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

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WHAT'S NEW

- PURE exited fiscal third quarter of 2015 with a relatively strong balance sheet;
- FCN will be resubmitted soon, representing a lucrative market for SDC products;
- Strong momentum on business development and operations;
- We expect strong revenue growth in fiscal 2015 and beyond;
- Maintain Buy rating and reiterate our 12-month target price of $3.00;

PURE Exited Fiscal Third Quarter With a Strong Balance Sheet

On June 11, PURE reported financial results for fiscal third quarter ended April 30, 2015.

Revenues for the fiscal 3Q15 were $109,000 compared with $261,000 for fiscal 3Q14, a decline of 58%. This was mainly due to uneven orders (a few times a year) by some customers.

But we are pleased to see that the revenue mix attributable to food safety solutions increased over prior fiscal quarters to approximately 50% of total revenues in fiscal Q3 2015, a sequential increase from less than 10% of total revenues from fiscal 2Q15.

Total operating costs and expenses, excluding cost of goods sold, share-based compensation, other share-based expenses, and restructuring costs, for the fiscal 3Q15 and 3Q14, were $1.4 million and $1.6 million, respectively.

Net loss for fiscal 3Q15 was $2.1 million ($0.05 per share) compared with $2.1 million ($0.07 per share) for fiscal 3Q14.

Adjusted net loss for fiscal 3Q15 and fiscal 3Q14 was $1.3 million and $1.3 million, respectively.

PURE exited the fiscal third quarter with a relatively strong balance sheet. As of April 30, 2015, cash and cash equivalents was $2.5 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 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 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.

PURE Plans to Resubmit FCN to the FDA

PURE has been discussing with the FDA after the withdrawal regarding PURE's new test data. Based on these constructive discussions, PURE intends to resubmit its Food Contact Notification (FCN) for the use of SDC as a **raw poultry processing aid before the end of June, 2015.**

The company believes that it has adequately addressed the FDA's prior issues through additional testing indicating silver residue levels of treated poultry with SDC to be virtually **non-detectable** and well below existing guidelines. This builds upon prior SDC test results indicating the ability to reduce Salmonella below detectable levels.

The FDA's FCN review period is 120 days from submission.

Upon the FDA's granting of the FCN, PURE intends to immediately submit the FCN to the Food Safety and Inspection Service (FSIS) of the USDA for a new technology review.

As part of the FSIS review process, PURE may be required to conduct in-plant process validation and optimization trials with the authorization of the USDA.

PURE intends to provide additional updates as the regulatory review and the potential approval processes advance.

PURE also intends to resubmit its **produce FCN**. The company is currently conducting additional produce testing for silver residue levels for the application of SDC as a processing aid for produce.

If the new test results continue to adequately address the prior FDA issues, PURE intends to resubmit its FCN for produce during the summer.

Further, 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 beef and pork thereafter.

Based on these updates, we expect the commercial launch of SDC as raw poultry processing aid and produce by **the end of calendar 2015**.

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 35 companies (up from 20+ last quarter), and is initiating discussions with other established distributors in this market.

PURE is diversifying its revenue in this channel with over a dozen national customers (poultry, meats, produce, bakery, pet food, tortillas). The company's distributors are also actively expanding adoption in their established customer base of more than 600 food processing plants.

Restaurants

PURE continues to build market reach into quick service restaurants (QSRs) and casual dining restaurant chains.

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 continues to extend the launch of phased U.S. national sales rollout with SUBWAY®Restaurants.

So far, 15 total new distribution points gained in the SUBWAY® network, providing initial market reach into 4,900 stores, or 17% of SUBWAY's® U.S. system. PURE also gained commitments from major California and Mid-Atlantic markets to bring PURE into their distribution network, representing potential for an additional market reach of 2,200 stores (8% of system).

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

PURE is now conducting late phase testing with two casual dining restaurant chains, each managing more than 1,600 restaurants.

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

Cruise Lines

PURE and Intercon Chemical Company, the exclusively licensed manufacturer of SDC-based products, continue to collaborate on Intercon's direct sales initiative for the commercial adoption of PURE Hard Surface disinfectant in the cruise line industry.

Intercon has shipped PURE Hard Surface disinfectant into a major international cruise line for on-ship pilot commercial testing for its U.S.-based fleet. Intercon intends to commence on-ship testing of PURE Hard Surface disinfectant with two additional cruise lines during calendar 2015.

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.

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;
- Subject to updated feedback from the FDA, secure FDA and USDA authorization for use of SDC as a direct food contact/processing aid for poultry, produce, beef and pork; and
- Continue to out-license PURE distribution and SDC applications to non-core markets.

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 $0.8 million, representing an increase of 45% 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.

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**.

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 $0.85 per share with a market cap of $35 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 117% 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.

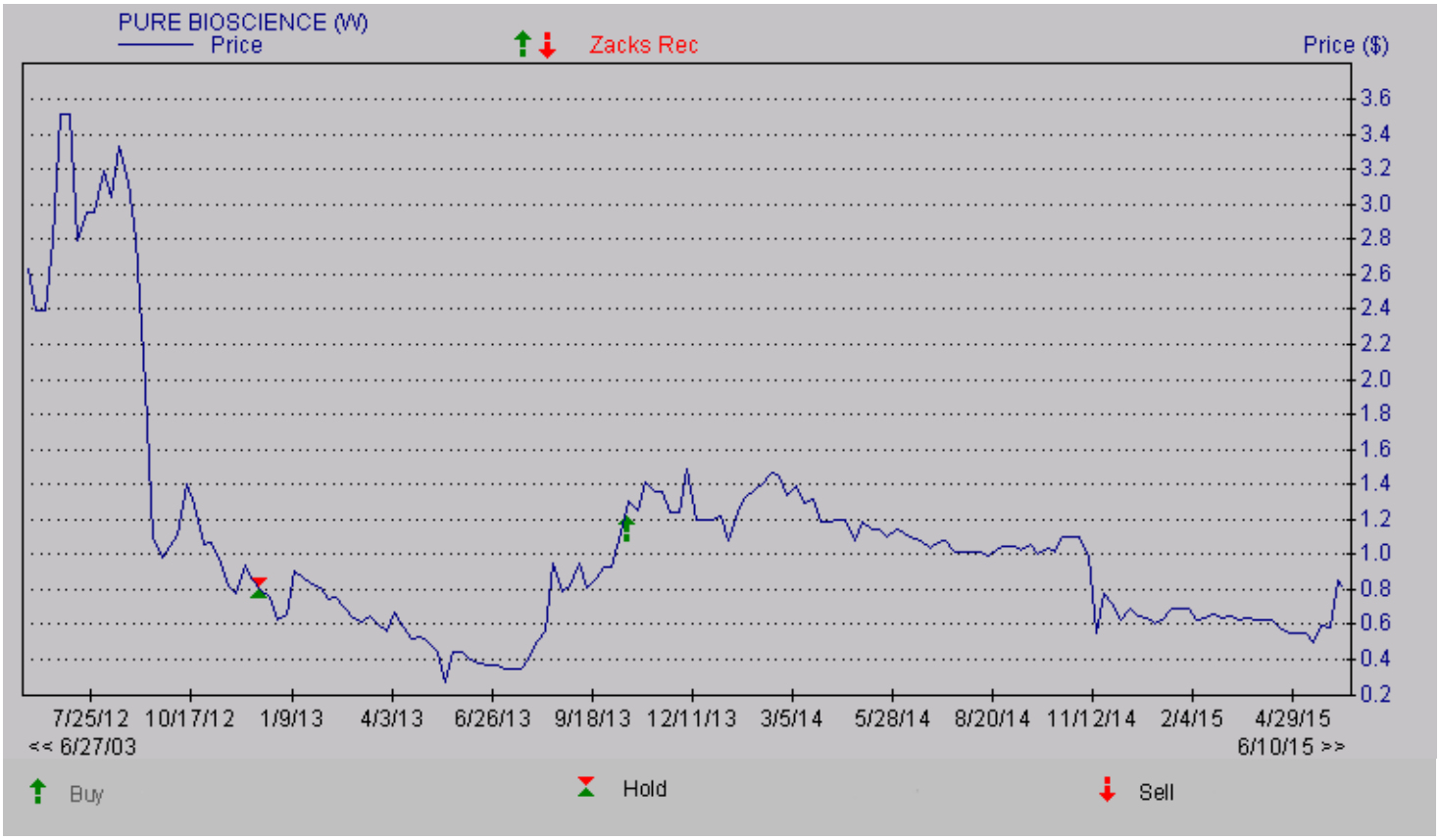
PROJECTED INCOME STATEMENT

	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	Q3A	Q4E	FYE	FYE	FYE	FYE	FYE	FYE
Total Revenues	**$0.12**	**$0.04**	**$0.26**	**$0.13**	**$0.55**	**$0.12**	**$0.27**	**$0.11**	**$0.30**	**$0.80**	**$3.50**	**$12.50**	**$22.50**	**$30.00**	**$38.50**
YOY Growth	*4.5%*	*-84.4%*	*1.2%*	*-29.6%*	*-32.9%*	*1.7%*	*565.9%*	*-58.2%*	*125.6%*	*45.3%*	*338.0%*	*257.1%*	*80.0%*	*33.3%*	*28.3%*
CoGS	0.04	0.02	0.09	0.20	0.34	0.05	0.11	0.07	0.09	0.24	0.70	2.50	4.50	6.00	7.70
Gross Income	**$0.08**	**$0.02**	**$0.17**	**($0.07)**	**$0.21**	**$0.07**	**$0.16**	**$0.04**	**$0.21**	**$0.56**	**$2.80**	**$10.00**	**$18.00**	**$24.00**	**$30.80**
Gross Margin	*68.7%*	*51.2%*	*65.9%*	*-49.6%*	*37.5%*	*61.5%*	*59.3%*	*40.4%*	*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	$0.17	$0.20	$0.76	$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%*	*156.9%*	*66.7%*	*95.4%*	*28.6%*	*9.6%*	*5.8%*	*4.8%*	*3.9%*
SG&A	$0.99	$1.24	$1.34	$1.48	$5.06	$1.19	$1.20	$1.21	$1.22	$4.82	$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%*	*1107.3%*	*406.7%*	*603.3%*	*185.7%*	*76.0%*	*48.9%*	*41.7%*	*35.1%*
Other	$2.68	$1.71	$0.77	$0.86	$6.02	$0.63	$0.48	$0.77	$0.50	$2.38	$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)**	**($2.1)**	**($1.7)**	**($7.4)**	**($4.7)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
Operating Margin	-	-	-	-	-	-	-	-	-	-	*-134.3%*	*-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)**	**($2.1)**	**($1.7)**	**($7.4)**	**($4.7)**	**($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)**	**($2.1)**	**($1.7)**	**($7.4)**	**($4.7)**	**($0.7)**	**$5.7**	**$10.1**	**$15.8**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	*-85.1%*	*-914.3%*	*76.3%*	*57.2%*
Net Margin	-	-	-	-	-	-	-	-	-	-	*-134.3%*	*-5.6%*	*25.3%*	*33.5%*	*41.0%*
Shares Out	*20.7*	*25.0*	*27.9*	*28.9*	*25.6*	*37.0*	*39.9*	*40.8*	*42.5*	*40.1*	*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)**	**($0.05)**	**($0.04)**	**($0.18)**	**($0.10)**	**($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)**	**($2.1)**	**($1.7)**	**($7.4)**	**($4.7)**	**($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)**	**($0.05)**	**($0.04)**	**($0.18)**	**($0.10)**	**($0.01)**	**$0.10**	**$0.17**	**$0.24**

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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