

PURE BIOSCIENCE, INC.  
Form 10-K  
October 29, 2012

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended July 31, 2012 or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file No. 0-21019

Pure Bioscience, Inc.  
(Exact name of registrant as specified in charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

33-0530289  
(IRS Employer  
Identification No.)

1725 Gillespie Way  
El Cajon, California 92020  
(Address of principal executive office, including zip code)

(619) 596-8600  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:  
None

Securities registered pursuant to Section 12(g) of the Act:  
Common Stock, \$0.01 par value

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Act). See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the registrant’s voting stock held by non-affiliates, as of the last day of the registrant’s second quarter of the fiscal year ended July 31, 2012, was approximately \$18,778,000 (computed on the basis of the last trade of the common stock on the NASDAQ Capital Market on January 31, 2012).

As of October 24, 2012, there were 10,986,170 shares of the registrant’s common stock, \$0.01 par value per share, outstanding.

Other Information

As used in this Annual Report on Form 10-K, the terms “we”, “us”, “our”, “PURE” and the “Company” refer to Pure Bioscience Inc., a Delaware corporation, and its subsidiary, on a consolidated basis, unless otherwise stated.



## TABLE OF CONTENTS

|   | Page |
|---|------|
| Part I  |      |
| Item 1. Business  | 2    |
| Item 1A. Risk Factors   | 9    |
| Item 1B. Unresolved Staff Comments  | 20   |
| Item 2. Properties  | 20   |
| Item 3. Legal Proceedings   | 20   |
| Item 4. Mine Safety Disclosures   | 20   |
| Part II   |      |
| Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases Equity Securities | 21   |
| Item 6. Selected Financial Data   | 22   |
| Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations                         | 22   |
| Item 7A. Quantitative and Qualitative Disclosures about Market Risk   | 31   |
| Item 8. Consolidated Financial Statements and Supplementary Data  | 31   |
| Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure                          | 31   |
| Item 9A. Controls and Procedures  | 32   |
| Item 9B. Other Information  | 32   |
| Part III  |      |
| Item 10. Directors, Executive Officers and Corporate Governance   | 33   |
| Item 11. Executive Compensation   | 35   |
| Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters               | 39   |
| Item 13. Certain Relationships and Related Transactions, and Director Independence                                    | 40   |
| Item 14. Principal Accounting Fees and Services   | 41   |
| Part IV   |      |
| Item 15. Exhibits, Financial Statement Schedules  | 42   |
| Signatures  | 46   |

## CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K may constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act. Forward-looking statements are based upon our current assumptions, expectations and beliefs concerning future developments and their potential effect on our business. In some cases, you can identify forward-looking statements by words such as “if,” “shall,” “may,” “might,” “will likely result,” “should,” “expect,” “anticipate,” “believe,” “estimate,” “project,” “intend,” “goal,” “objective,” “predict,” “potential” or “continue,” or the negative terms and other comparable terminology, although the absence of these words does not necessarily mean that a statement is not forward-looking. Additionally, statements concerning future matters such as the development of new products, sales levels, expense levels, cash flows, future financing matters, future partnering opportunities and other statements regarding matters that are not historical are forward-looking statements.

Although the forward-looking statements in this Annual Report reflect our good faith judgment, based on currently available information, they involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the “Risk Factors” contained in Part I, Item 1A of this Annual Report. As a result of these factors, we cannot assure you that the forward-looking statements in this Annual Report on Form 10-K will prove to be accurate. Except as required by law, we undertake no obligation to update publicly any forward-looking statements for any reason after the date we file this Annual Report with the Securities and Exchange Commission, or to conform these statements to actual results or to changes in our expectations. You should, however, review the factors and risks we describe in the reports we will file from time to time with the Securities and Exchange Commission after the date we file this Annual Report. Readers are urged to carefully review and consider the various disclosures made in this Annual Report.

## PART I

Effective on August 14, 2012 and commencing with the opening of trading on August 15, 2012, we effected a reverse stock split of our issued and outstanding common stock, \$0.01 par value per share, at a ratio of one-for-eight, with each eight (8) issued and outstanding shares of our common stock automatically combined and converted into one (1) issued and outstanding share of our common stock.. The reverse stock split was approved by stockholders holding a majority of our outstanding voting power at our annual meeting of stockholders held on July 31, 2012. All information in this report, including in the consolidated financial statements included herein, regarding share amounts of our common stock and prices per share of our common stock has been adjusted to reflect the application of the reverse stock split on a retroactive basis, unless otherwise noted.

### Item 1. Business

#### Overview

We are focused on the discovery, development and commercialization of bioscience products that provide solutions to global health challenges. Our technology platform is based on stabilized ionic silver, and our initial products contain silver dihydrogen citrate, or SDC. SDC is a broad-spectrum, non-toxic antimicrobial. We manufacture and sell SDC-based disinfecting and sanitizing products, which are registered by the Environmental Protection Agency, or EPA, to distributors and end users. We also manufacture and sell various SDC-based formulations to manufacturers for use as a raw material in the production of personal care and other products. We believe our technology platform has potential application in a number of industries, and we have ongoing research and development projects in food processing, agriculture, water treatment, pharmaceuticals, and oil and gas.

#### Technology Platform

The foundation of our technology platform is a proprietary electrochemical process that allows us to generate ionized silver in the presence of organic acid. This process creates a solution containing stabilized ionic silver that can function as an antimicrobial. Our current products all contain SDC, which is produced by ionizing silver in citric acid. SDC is non-toxic, non-caustic, colorless, odorless and formulates well with other compounds. We believe that SDC is distinguished from other products in the marketplace because of its superior efficacy and toxicity profiles. We have also produced ionic silver-based molecular entities using other organic acids, and we believe these compounds may provide a platform for future product development.

#### Business Strategy

Our goal is to become a sustainable company by using our proprietary technology platform to deliver leading antimicrobial products to multiple industries.

Key aspects of our corporate strategy include:

- Expanding sales and distribution for currently marketed products;
  - Increasing use of SDC in third party products and processes;
- Establishing strategic alliances to maximize the commercial potential of our technology platform;
  - Developing additional proprietary products and applications; and
    - Protecting and enhancing our intellectual property.

In addition to our current products, we seek to leverage our technology platform to develop new products, enter new markets and establish new partnerships that could potentially generate multiple sources of revenue.

#### Products

We manufacture and sell SDC-based products for end use, products preserved with SDC and SDC as a raw material for manufacturing use. Our current products are as follows:

| Product Name                           | Product Use                | EPA Registration |
|--|----------------------------|------------------|
| PURE Complete System:                  |                            |                  |
| PURE® Hard Surface                     | Disinfectant and sanitizer | SDC3A            |
| PURE Multi-Purpose Cleaner Concentrate | Cleaner                    | Not applicable   |
| PURE Floor Cleaner Concentrate         | Cleaner                    | Not applicable   |
| Axen® 30                               | Disinfectant               | Axen30           |
| Axenohl®                               | Raw material               | Axenohl          |
| Silvérion®                             | Raw material               | Not applicable   |

#### PURE Complete System

Our PURE Complete System is comprised of PURE® Hard Surface and our two new cleaning products that were launched as companion products to PURE® Hard Surface, PURE Multi-Purpose Cleaner and PURE Floor Cleaner. The PURE Complete System offers a comprehensive, cost-effective and user-friendly product line to end-users, janitorial service providers and the distributors that supply them.

#### PURE® Hard Surface

PURE® Hard Surface is our patented and EPA-registered hard surface disinfectant and food contact surface sanitizer. We manufacture both consumer and commercial versions of the product. PURE Hard Surface combines high efficacy and low toxicity with 30-second bacterial and viral kill times and 24-hour residual protection. The product completely kills resistant pathogens such as MRSA and Carbapenem-resistant *Klebsiella pneumoniae* (NDM-1), and effectively eliminates dangerous fungi and viruses including HIV, Hepatitis B, Hepatitis C, Norovirus, Influenza A, Avian Influenza and H1N1. It also eradicates hazardous food pathogens such as *E. coli*, *Salmonella*, *Campylobacter* and *Listeria*. PURE Hard Surface delivers broad-spectrum efficacy yet remains classified as least-toxic by the EPA. The active ingredient, SDC, has been designated as Generally Recognized as Safe, or GRAS, for use on food processing equipment, machinery and utensils.

#### PURE Multi-Purpose and Floor Cleaner Concentrates

Our recently launched cleaning products, PURE Floor Cleaner and PURE Multi-Purpose Cleaner, are environmentally responsible cleaning products that are protected by SDC, a natural, non-toxic antimicrobial. SDC ensures the quality and safety of PURE Floor Cleaner and PURE Multi-Purpose Cleaner without human or environmental exposure to toxic chemical preservatives. PURE Floor Cleaner and PURE Multi-Purpose Cleaner are non-toxic and non-flammable and contain no EDTA, phosphates, ammonia or bleach as well as no VOCs or NPEs. PURE Floor Cleaner and PURE Multi-Purpose Cleaner provide professional strength cleaning in a concentrate formula that yields a 1:128 use dilution that is safe for use on all resilient surfaces.

#### Axen® 30

Axen®30 is our patented and EPA-registered hard surface disinfectant and is a predecessor product to PURE® Hard Surface. Axen30 is sold by distributors under the private label brands SpectraSan24, PureGreen24, Critical Care, Mother Nature's Choice and Ag+ainst24. In prior years, we sold this product to other distributors that resold Axen30 under a variety of other private label brands.

#### Axenohl®

Axenohl® is our patented and EPA-registered antimicrobial formulation for use as a raw material in the manufacturing of EPA-registered products. Axenohl is a colorless, odorless and stable solution that provides fast acting efficacy against bacteria, viruses and fungi when manufactured into consumer and commercial disinfecting and sanitizing products.

#### Silvérion®

Silvérion® is our patented antimicrobial formulation for use as a raw material in the manufacturing of personal care products. It can be used as either an active ingredient or a preservative. Silvérion is a colorless, odorless and stable solution that provides ionic silver in a water-soluble form. It provides fast acting efficacy at low concentrations against a broad-spectrum of bacteria, viruses, yeast and molds.

#### EPA Registrations

We sell our EPA-regulated products under the following three EPA registrations: (i) SDC3A, our hard surface disinfectant and food contact surface sanitizer, (ii) Axen30, our hard surface disinfectant, and (iii) Axenohl, our antimicrobial formulation for use as a raw material in the manufacturing of EPA-registered products.





## SDC3A Registration

The EPA registration for SDC3A, marketed as PURE Hard Surface, our disinfectant and food contact surface sanitizer, includes the following efficacy claims:

| Organism  | Kill Time  |
|---|------------|
| <i>Pseudomonas aeruginosa</i>   | 30 seconds |
| <i>Salmonella enterica</i>  | 30 seconds |
| <i>Staphylococcus aureus</i>  | 2 minutes  |
| <i>Listeria monocytogenes</i>   | 2 minutes  |
| Vancomycin resistant <i>Enterococcus faecium</i> (VRE)                                | 2 minutes  |
| Methicillin resistant <i>Staphylococcus aureus</i> (MRSA)                             | 2 minutes  |
| Community Associated Methicillin resistant <i>Staphylococcus aureus</i> (CA-MRSA)     | 2 minutes  |
| Community Associated Methicillin resistant <i>Staphylococcus aureus</i> (CA-MRSA-PVL) | 2 minutes  |
| <i>Escherichia coli</i> O157:H7   | 2 minutes  |
| <i>Acinetobacter baumannii</i>  | 2 minutes  |
| <i>Campylobacter jejuni</i>   | 2 minutes  |
| Carbapenem resistant <i>Escherichia coli</i>  | 2 minutes  |
| Carbapenem resistant <i>Klebsiella pneumoniae</i>                                     | 2 minutes  |
| Carbapenem resistant <i>Klebsiella pneumoniae</i> , NDM-1 +                           | 2 minutes  |
| <i>Trichophyton mentagrophytes</i> (Athlete's Foot Fungus)                            | 5 minutes  |
| HIV type 1  | 30 seconds |
| Rotavirus   | 30 seconds |
| Human Coronavirus   | 30 seconds |
| Influenza A (H1N1)  | 30 seconds |
| Swine Influenza A (H1N1)  | 30 seconds |
| Respiratory Syncytial Virus   | 30 seconds |
| Adenovirus Type 2   | 30 seconds |
| Avian Influenza A   | 30 seconds |
| Influenza A   | 30 seconds |
| Hepatitis B Virus (HBV)   | 60 seconds |
| Hepatitis C Virus (HCV)   | 60 seconds |
| Murine Norovirus  | 60 seconds |
| Norovirus   | 60 seconds |
| Herpes Simplex Type 1   | 60 seconds |
| Rhinovirus  | 60 seconds |
| Polio Type 2  | 60 seconds |

The EPA registration for SDC3A also claims 24 hour residual protection against bacteria.

The EPA categorizes the toxicity of antimicrobial products from Category I to Category IV. The following table shows the EPA toxicity categories and required signal words.

| Toxicity Category | Signal Word    |
|-------------------|----------------|
| I                 | DANGER, POISON |
| II                | WARNING        |

III  
IV

CAUTION  
None required

SDC3A is a Category IV product for which no signal words are required.

4

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#### Axen30 Registration

Axen@30 is a hard surface disinfectant and is a predecessor product to SDC3A. It offers similar broad-spectrum efficacy but less effective kill times. Axen30 is not approved for use on food contact surfaces.

#### Axenohl Registration

Axenohl is registered as a raw material for the manufacturing of EPA-registered products and as such does not carry specific efficacy claims.

#### Intellectual Property

Our policy is to pursue patents, pursue trademarks, maintain trade secrets and use other means to protect our technology, inventions and improvements that are commercially important to the development of our business.

We have applied for U.S. and foreign patent protection for our SDC technology. Currently, we own nine patents which have been issued in the U.S. and approximately seventy-two patents which have been issued outside of the U.S. Additionally, we own approximately eighty-four patents pending around the world. The expiration dates for our nine issued U.S. patents begin in 2018 and end in 2024. Additional patent applications may not be granted, or, if granted, may not provide adequate protection to us. We also intend to rely on whatever protection the law affords to trade secrets, including unpatented know-how. Other companies, however, may independently develop equivalent or superior technologies or processes and may obtain patents or similar rights with respect thereto.

Although we believe that we have developed our technology independently and have not infringed, and do not infringe, on the patents of others, third parties may make claims that our technology does infringe on their patents or other intellectual property. In the event of infringement, we may, under certain circumstances, be required to modify our infringing product or process or obtain a license. We may not be able to do either of those things in a timely manner if at all, and failure to do so could have a material adverse effect on our business. In addition, we may not have the financial or other resources necessary to enforce a patent infringement or proprietary rights violation action or to defend ourselves against such actions brought by others. If any of the products we develop infringe upon the patent or proprietary rights of others, we could, under certain circumstances, be enjoined or become liable for damages, which would have a material adverse effect on our business.

We also rely on confidentiality and nondisclosure agreements with our employees, consultants, advisors, licensees and potential partners to protect our technology, intellectual property and other proprietary property. Pursuant to the foregoing and for other reasons, we face the risk that our competitors may acquire information which we consider to be proprietary, that such parties may breach such agreements or that such agreements will be inadequate or unenforceable.

Further, we own the registered trademarks or pending trademark applications for PURE Bioscience®, Powered by SDC Ag+®, Staph Attack®, Staphacide®, Axenohl®, Axen®, Silvéron®, Kinderguard®, Cruise Control®, Nutripure™, Elderguard®, and Critterguard®. In addition, we have applications for other trademarks pending around the world, which may or may not be granted.

#### Scientific Background

##### Silver as an Antimicrobial

The use of silver as an antimicrobial dates back to ancient times when water, wine and other beverages were kept in silver vessels to maintain freshness. Ancient Egyptians applied thin strips of beaten silver around wounds to avoid infection, and early royalty ate from silver plates and with silver utensils to stay healthy. In the past half-century, silver in colloidal and ionic forms has been used successfully in a wide array of antimicrobial applications, including water purification and topical treatments for burn victims. Silver must be in an ionic or colloidal form to be effective at killing microorganisms. The short shelf-life of previous ionic silver solutions has limited the development of

ionic-silver based antimicrobials. SDC, as a stabilized silver ion complex, has a shelf life of more than a decade because the weak bond of the silver ion to the citric acid allows the ion to remain stable in solution while at the same time making it bioavailable for antimicrobial action.

#### SDC

SDC is a patented antimicrobial based on a stabilized silver ion complex. SDC is produced by a unique electrochemical process using silver and citric acid. The resulting solution is a colorless, low viscous liquid containing a water soluble silver salt of citric acid.

#### Mechanisms of Action

The rapid and broad-spectrum efficacy of SDC is attributed to its dual mechanisms of action, both with respect to killing bacteria and other microorganisms and acting against viruses.

SDC can kill microorganisms at both the extracellular and intracellular levels. SDC attracts bacteria because the citric acid is recognized by the organism as a food source. SDC easily enters the microorganism through membrane transport proteins. Once inside the organism, SDC binds to DNA and intracellular proteins causing irreversible damage to the DNA and protein structure. Metabolic and reproductive functions halt, and the organism dies. SDC can also act on an organism's outer membrane. Silver ions are highly attracted to sulfur-containing thiol groups found in metabolic and structural proteins bound to the membrane surface. SDC targets these critical proteins and destroys their structure. This disruption of the organism's membrane function and integrity lyses the membrane and the organism dies.

Viruses are much smaller than bacteria and present fewer target sites on which a biocide can act. The efficacy of SDC against enveloped and non-enveloped viruses comes from its ability to destroy not only the viral envelope, preventing the virus from attaching to a host cell, but also the infectious component of the virus, the nucleic acid.

#### Safety Profile

Research has shown that silver is an effective antimicrobial and not toxic to humans. In addition, our data shows the components of SDC, ionic silver and citric acid, to be non-toxic, particularly at the low concentrations required to eliminate microorganisms. At higher concentrations, citric acid can be an eye irritant. We have tested a concentrated SDC formulation using standard protocols to measure acute toxicity. Our results demonstrate that there is no toxicity associated with SDC. Acute oral and dermal toxicity was not observed at doses up to and including 5000 mg/kg, indicating lack of toxicity. Data from the eye and skin studies showed only slight irritation and no dermal sensitization.

SDC has been designated Generally Recognized as Safe, or GRAS, when used on food processing equipment, machinery and utensils. A committee of independent experts critically reviewed efficacy and toxicity data for SDC and PURE Hard Surface. The committee found no evidence that SDC demonstrates a hazard to the public when used on food contact surfaces and food-use utensils and therefore concluded this use as GRAS.

#### Efficacy

Formulations containing SDC provide complete, quick and broad-spectrum antimicrobial efficacy against gram positive and gram negative bacteria, enveloped and non-enveloped viruses, and fungi. In addition to quick kill times, SDC provides residual antimicrobial activity. SDC also provides rapid kill times against multiple drug resistant bacteria including Methicillin-resistant *Staphylococcus aureus*, or MRSA, Vancomycin resistant *Enterococcus faecium*, or VRE, Carbapenem resistant *Escherichia coli*, Carbapenem resistant *Klebsiella pneumoniae* and Carbapenem resistant *Klebsiella pneumoniae*, NDM-1. See the section of this Item 1 entitled "EPA Registrations" for detailed efficacy data.

#### Natural and Environmentally Responsible

SDC is made of simple and all-natural ingredients: water, citric acid and minute amounts of ionic silver. SDC is non-toxic. The safety profile for silver has been extensively reviewed in public literature and by US government agencies and international organizations including the EPA, the Food and Drug Administration, or FDA, the Agency for Toxic Substances and Disease Registry, the World Health Organization and the National Resource Center for Health Information Technology. There is no evidence of mutagenicity, carcinogenicity, neurotoxicity, reproductive or developmental effects due to silver.

SDC does not harm the environment. If introduced to water systems, the low concentrations of ionic silver in SDC would react with naturally present substances such as chlorides, sulfides and organic matter. These reactions would create insoluble silver complexes and render the silver inert.

SDC is manufactured through a "zero waste" process in which no byproducts are created.

#### Research and Development

We recognize the importance of innovation to our long-term success. A key aspect of our business strategy is to leverage our technology platform to develop additional proprietary products and applications. We are focused on the development of end use products and raw material formulations derived from our technology platform. We conduct our primary research and development activities in-house and use third-party laboratories to conduct independent testing. We also engage development partners to perform research and development activities at their own expense for specific products and processes using SDC. Amounts spent on research and development activities during the fiscal years ended July 31, 2012 and 2011 were \$1,863,000 and \$2,180,000, respectively.

We have developed several new SDC-based products, including a dilutable sanitizer and virucide, and skin cleansing wipes. We are in the early stage of introducing these products. In addition, we are continuing development of various other SDC-based product candidates including a dilutable food contact surface sanitizer, hard surface disinfecting wipes and other textile applications, a cleaner/disinfectant product, foaming cleaner/sanitizer products, products for use in the natural gas and petroleum industries, formulations for industrial biofilm control, high level disinfectants, agriculture treatments, food processing aids, food additives and preservatives, water treatment formulations as well as medical device and pharmaceutical products.

## Sales and Marketing

### Overview

A key aspect of our business strategy is to establish strategic alliances in order to maximize the commercial potential of our technology platform. We seek to form partnerships with industry leaders for a variety of uses and applications of our products and technology. We market and sell disinfecting and sanitizing products, which are registered by the EPA, to distributors and end users. We also market and sell various SDC-based formulations to manufacturers for use as a raw material in the production of personal care and other products. In addition, we license our products and technology to development and commercialization partners.

### New Key Distributors

In the past, we have outsourced the sales and marketing of our products by engaging one or more exclusive distributors and sales agents. Although we may elect to pursue that strategy again in the future, we currently manage, and expect to continue to manage, our product sales internally and pursue engagements with strategically advantageous distributors of those products. Consistent with that strategy, we recently secured relationships with two key distributors of our SDC-based products, AHI Facility Services, Inc. and Intercon Chemical. AHI Facility Services, Inc. is a regional strategic customer in the contract facilities market with a large base of clients, many of which are currently using our products in their corporate headquarters. Intercon Chemical distributes the PURE Complete System through its established network of more than 200 distributors that service approximately 250,000 end-use customers, and has promoted the PURE Complete System at several recent conferences and trade shows.

### FTA Bioscience, LLC

In June 2010, we entered into three exclusive license and supply agreements with FTA Bioscience, LLC, or FTA, to develop and commercialize our patented SDC-based technology in wound care, as well as the treatment of nail fungus and athlete's foot.

### Competition

The markets for SDC and each of its potential applications are highly competitive. We have a number of competitors that vary in size, scope and breadth of products offered. Such competitors include some of the largest global corporations, and many of our competitors have significantly greater financial resources than we do. We expect to face additional competition from other competitors in the future.

Because SDC is a new technology, our success will depend, in part, upon our ability to achieve a share of our target markets at the expense of established and future products. Even where SDC may have technological competitive advantages over competing products, we, our partners or our distributors, will need to invest significant resources in order to attempt to displace traditional technologies sold by, what are in many cases, well-known international industry leaders. Alternatively, we may pursue partnerships with existing competitors whereby these competitors would incorporate our products into their existing brands. This would reduce the proportion of end-use revenue that would accrue to us. To the extent that we were to grant any existing competitor exclusivity to any field or territory, we would risk having our technology marketed in a manner that may be less than optimal for us. We recognize that innovative marketing methods are required in order to establish our products, and that such methods may not be successful.

### Manufacturing

We manufacture and package our disinfectant and sanitizing products as well as various raw material formulations at our corporate headquarters in El Cajon, California. We have previously outsourced some manufacturing and packaging operations to one or more third parties, and may do so in the future where it is economically advantageous; however, we intend to maintain exclusive manufacturing of SDC-based raw material formulations in our facility.



Silver is the primary active ingredient in SDC and is a readily available commodity. The other active and inactive ingredients in our products are readily available from multiple sources.

#### Government Regulation

Our business is subject to various government regulations relating to the protection of public health and the environment. Among these are laws that regulate the manufacture, storage, distribution and labeling of our products, as well as the use, handling, storage and disposal of certain materials in the manufacturing of our products.

### Regulation in the United States

Certain environmental and regulatory matters significant to us are discussed below.

#### Requirements Imposed by the EPA and Similar State Agencies

We manufacture and sell in the U.S. certain disinfecting products that kill or reduce microorganisms (bacteria, viruses, fungi). The manufacture, labeling, handling and use of these products are regulated by the EPA under the Federal Insecticide, Fungicide, and Rodenticide Act, or FIFRA. We currently sell three products registered by the EPA under FIFRA, certain of which are approved for use on food contact surfaces and others of which are approved for use on non-food contact hard surfaces. EPA product registration requires meeting certain efficacy, toxicity and labeling requirements and paying ongoing registration fees.

Although generally states do not impose substantive requirements different from those of the EPA, each state in which these products are sold requires registration and payment of a fee. California and certain other states have adopted additional regulatory programs applicable to these types of products that, in some cases, impose a fee on total product sales in the state.

Based on our experience and our knowledge of current trends, we expect the costs and delays in receiving necessary federal and state approvals for these types of products may increase in the coming years.

#### Requirements Imposed by Ingredient Legislation

Numerous federal, state and local laws regulate the sale of products containing certain identified ingredients that may impact human health and the environment. For instance, California has enacted Proposition 65, which requires the disclosure of specified listed ingredient chemicals on the labels of products. Although none of the ingredients in our current products is reportable under Proposition 65, this and other similar legislation may become more comprehensive in the future and/or new products we may develop could be subject to these regulations.

#### Requirements Imposed by Other Environmental Laws

A number of federal, state and local environmental, health and safety laws govern the use, handling, storage and disposal of certain materials. Our current manufacturing process for SDC-based products is a “zero waste” process, meaning that no byproducts are created, and we do not use hazardous materials, as defined by applicable environmental laws, in the manufacturing of these products. As such, some of these U.S. environmental laws are not generally applicable to us in their current form. However, these laws may in the future identify as hazardous materials certain materials that we use in our manufacturing processes, or we may opt to or be forced to change our manufacturing procedures in a way that subjects our products or operations to these laws.

### Regulation Outside the United States

The commercialization of SDC-based products in countries other than the U.S. requires that we, or companies with whom we partner for such foreign commercialization, obtain necessary approvals of the regulatory authorities in such foreign countries comparable to the EPA, among others. Applicable approval processes and ongoing requirements vary from country to country and may involve more time and expense than that required to obtain approvals for U.S. sales of our products.

### Employees

As of October 24, 2012, we employed 23 regular full-time employees. We believe that we have been successful in attracting skilled and experienced personnel, but competition for personnel is intense and there can be no assurance that we will be able to attract and retain qualified personnel in the future. None of our employees are covered by collective bargaining agreements and we consider relations with our employees to be good.

### Company Information

We were incorporated in the state of California in August 1992 as Innovative Medical Services. In September 2003, we changed our name to Pure Bioscience. In March 2011, we reincorporated in the state of Delaware under the name “Pure Bioscience, Inc.”

Our corporate offices are located at 1725 Gillespie Way, El Cajon, California 92020. Our telephone number is (619) 596-8600. Our website address is [www.purebio.com](http://www.purebio.com). We make available free of charge on our website our periodic and current reports, proxy statements and other information as soon as reasonably practicable after such reports are filed with the Securities and Exchange Commission, or SEC. Information contained on, or accessible through, our website is not part of this report or our other filings with the SEC. Our SEC filings are also available to the public from the SEC’s website at [www.sec.gov](http://www.sec.gov).

## Item 1A. Risk Factors

You should carefully consider the following information about risks and uncertainties that may affect us or our business, together with the other information appearing elsewhere in this Annual Report on Form 10-K, including our consolidated financial statements and the related notes thereto. If any of the following events, described as risks, actually occur, either alone or taken together, our business, financial condition, results of operations and future growth prospects would likely be materially and adversely affected. In these circumstances, the market price of our common stock could decline, and you may lose all or part of your investment in our securities. An investment in our securities is speculative and involves a high degree of risk. You should not invest in our securities if you cannot bear the economic risk of your investment for an indefinite period of time and cannot afford to lose your entire investment. There may be additional risks that we do not presently know of or that we currently believe are immaterial which could also impair our business and financial position.

### Risks Related to Our Business and Industry

We will need to raise additional capital in order to continue operating our business and continue to develop new products and technologies, and such additional funds may not be available on acceptable terms or at all

We have not generated, and may never generate, significant cash from operations and must raise additional funds in order to continue operating our business. Our cash outflows for operating activities and for investments in patents and fixed assets were \$5.8 million in the year ended July 31, 2012, and \$6.4 million in the year ended July 31, 2011. Cash outflows may be greater in future periods.

Our capital requirements will depend on many factors, including, among other factors:

- the acceptance of, and demand for, our products;
- our success and that of our strategic partners in developing and selling products derived from our technology;
  - the costs of further developing our existing, and developing new, products or technologies;
  - the extent to which we invest in new technology, testing and product development;
- the timing of vendor payments and of the collection of receivables, among other factors affecting our working capital;
  - the exercise of outstanding options or warrants to acquire our common stock;
  - the number and timing of acquisitions and other strategic transactions, if any; and
  - the costs associated with the continued operation, and any future growth, of our business.

We will need to increase our liquidity and capital resources. We expect to rely in the near term on funds raised pursuant to an underwritten public offering closed on September 17, 2012 of an aggregate of 4,341,615 shares of our common stock (including shares issued pursuant to the exercise of the underwriter's overallotment option), as well as funds raised pursuant to two recent private placement offerings of our common stock and other equity (although we have used certain of those funds to repay the principal balance owed under the Bridge Loan (as defined below)). However, we anticipate that we will require additional capital in future periods to continue our operations and further develop our products and technologies. Until we can generate a sufficient amount of revenue to finance our cash requirements, which we may never do, we expect to increase our liquidity and capital resources by one or more measures, which may include reducing operating expenses, raising additional financing through the issuance of debt, equity, or convertible securities, entering into partnerships, licenses, or other arrangements with third parties, reducing the exercise price of outstanding warrants, or through other means, any one of which could reduce the value to us, perhaps substantially, of our technology and its commercial potential. There is no guarantee that we will be able to obtain capital on terms acceptable to us, or at all. Insufficient funds would result in a material adverse effect on our business and operations and could cause us to fail to execute our business plan, fail to take advantage of future opportunities, or fail to respond to competitive pressures or customer requirements, and further may require us to delay, scale back or eliminate some or all of our research and product development programs, license to third parties

the right to commercialize products or technologies that we would otherwise commercialize ourselves, reduce our operations, or otherwise significantly modify our business model or cease operations altogether. Modification of our business model and operations could result in an impairment of assets, which cannot be determined at this time. Furthermore, if we continue to issue equity or convertible debt securities to raise additional funds, our existing stockholders may experience dilution, and the new equity or debt securities may have rights, preferences and privileges that are superior to those of our existing stockholders. If we incur additional debt, it may increase our leverage relative to our earnings or to our equity capitalization.

We have a history of losses, and we may not achieve or maintain profitability

We had a loss of \$8.9 million for the year ended July 31, 2012, and a loss of \$8.3 million for the year ended July 31, 2011. As of July 31, 2012, we had an accumulated deficit of approximately \$62.5 million. Although we expect to continue to have losses in future periods, we are unable to predict the extent of our future losses or when or if we will become profitable, and it is possible we will never become profitable. Even if we do achieve profitability, we may not be able to sustain or increase profitability on an ongoing basis.

None of our existing agreements contain provisions that guarantee us any minimum revenues. If the penetration into the marketplace of SDC and SDC-based products is unsuccessful, revenue growth is slower than anticipated or operating expenses exceed expectations, it may take an unforeseen period of time to achieve or maintain profitability and we may never achieve or maintain profitability. Slower than anticipated revenue growth could force us to reduce research, testing, development and marketing of our technologies, and/or force us to reduce the size and scope of our operations, to sell or license our technologies to third parties, or to cease operations altogether.

The risks associated with our business may be more acute during periods of economic slowdown or recession. In addition to other consequences, these periods may be accompanied by decreased consumer and institutional spending in general, as well as decreased demand for, or additional downward pricing pressure on, our products. Accordingly, any prolonged economic slowdown or a lengthy or severe recession with respect to either the U.S. or the global economy is likely to have a material adverse effect on our results of operations, financial condition and business prospects. As a result, given the current weakness and uncertainties in the U.S. and in certain overseas economies, we expect that our business will continue to be adversely affected for so long as, and to the extent that, such adverse economic conditions and uncertainty exist.

Raising additional funds by issuing securities or through collaboration and licensing arrangements may cause dilution to existing stockholders, restrict our operations or require us to relinquish proprietary rights

We expect that we will need to increase our liquidity and capital resources in our current fiscal year and in future periods. We have a history of raising funds through offerings of our common stock, and we may in the future raise additional funds through public or private equity offerings, debt financings or corporate collaborations and licensing arrangements. To the extent that we raise additional capital by issuing equity securities, our stockholders' ownership will be diluted. Additionally, any debt financing we obtain may involve covenants that restrict our operations. These restrictive covenants may include, among other things, limitations on borrowing, specific restrictions on the use of our assets, as well as prohibitions on our ability to create liens on our assets, pay dividends on or redeem our capital stock or make investments. In addition, if we raise funds through collaboration and licensing arrangements, it may be necessary to grant licenses on terms that are not favorable to us or relinquish potentially valuable rights to our products or proprietary technologies. We may be required in future collaborations to relinquish all or a portion of our sales and marketing rights with respect to our products or license intellectual property that enable licensees to develop competing products in order to complete any such transaction.

As a result of the reverse stock split that we recently effected, the number of our outstanding shares of common stock was reduced at a ratio of one-for-eight, while the number of our authorized shares of common and preferred stock did not change. Accordingly, our authorized common stock remains 100,000,000 shares. In addition to capital raising activities, other possible business and financial uses for our authorized common stock include, without limitation, future stock splits, acquiring other companies, businesses or products in exchange for shares of common stock, issuing shares of our common stock to partners in connection with strategic alliances, attracting and retaining employees by the issuance of additional securities under our various equity compensation plans, satisfying any debt we may have by issuing equity securities, or other transactions and corporate purposes that our Board of Directors, or Board, deems are in our best interest. Additionally, shares of common stock could be used for anti-takeover purposes or to delay or prevent changes in control or management of the Company. For example, without further stockholder approval, our Board could approve the sale of shares of common stock in a private transaction to purchasers who may oppose a takeover or favor our current Board. We cannot provide assurances that any issuances of common stock will be consummated on favorable terms or at all, that they will enhance stockholder value, or that they will not adversely affect our business or the trading price of our common stock.

Under our Certificate of Incorporation, our Board could also authorize the issuance of up to 5,000,000 shares of preferred stock on terms determined by the Board. If any common or preferred stock is issued, the interests of holders of our common stock could be diluted, and shares of preferred stock could be issued in a financing in which investors

purchase preferred stock with rights, preferences and privileges that may be superior to those of the common stock, and the market price of our common stock could decline.

If outstanding options and warrants to purchase shares of our common stock are exercised, the interests of our stockholders could be diluted

As of October 24, 2012, in addition to 10,986,170 shares of common stock issued and outstanding, we currently have 323,463 shares reserved for issuance under equity compensation plans for vested and unvested stock options. We also have 803,321 shares reserved for issuance on the exercise of outstanding warrants.

We may elect to reduce the exercise price of outstanding warrants as a means of providing additional financing to us. The exercise of options and warrants, and the sale of shares underlying such options or warrants, could have an adverse effect on the market for our common stock, including the price that an investor could obtain for their shares. Investors may experience dilution in the net tangible book value of their investment upon the exercise of outstanding options and warrants granted under our stock option plans, and options and warrants that may be granted or issued in the future.

Because we are an early stage company, it is difficult to evaluate our prospects; our financial results may fluctuate and these fluctuations may cause our stock price to fall

Since acquiring the rights to our SDC technology, we have encountered and likely will continue to encounter risks and difficulties associated with introducing or establishing our products in rapidly evolving markets. These risks include the following, among others:

- we may not increase our sales to our existing customers and/or expand our customer base;
- we may not succeed in materially penetrating markets and applications for our SDC technology; our new sales and marketing strategy, which is built on our direct control of the sales and marketing of our products, may not be successful;
- we or our partners and/or distributors may not establish or maintain effective marketing programs and create product awareness or brand identity;
  - our partners' and/or distributors' goals and objectives may not be consistent with our own;
  - we may not attract and retain key business development, technical and management personnel;
- we may not maintain existing, or obtain new, regulatory approvals for our technology and products;
  - we may not succeed in locating strategic partners and licensees of our technology;
    - we may not effectively manage our anticipated growth, if any; and
    - we may not be able to adequately protect our intellectual property.

Any failure to successfully address these risks and uncertainties could seriously harm our business and prospects. We may not succeed given the technological, marketing, strategic and competitive challenges we face. In addition, because of our limited operating history and the early stage of market development for our SDC technology, we have limited insight into trends that may emerge and affect our business. Forecasting future revenues is difficult, especially because our technology is novel, and market acceptance of our products could change rapidly. In addition, our customers and potential customers in the foreseeable future are highly concentrated. Fluctuations in the buying patterns of our current or potential customers could significantly affect the level of our sales on a period to period basis. As a result, our financial results could fluctuate to an extent that may adversely affect our stock price. There are a number of other factors that could cause our financial results to fluctuate unexpectedly, including product sales, the mix of product sales, the cost of product sales, our ability for any reason to be able to meet demand, the achievement and timing of research and development and regulatory milestones, changes in expenses, including non-cash expenses such as the fair value of stock options granted, and manufacturing or supply issues, among other issues.

We are dependent on our core SDC technology and if our efforts to achieve or maintain market acceptance of our core SDC technology are not successful, we are unlikely to attain profitability

We have and are currently focusing substantially all of our time and financial resources in the development and commercialization of our core SDC technology. We believe SDC has applications in multiple industries and we expect that sales of SDC and SDC-based products will constitute a substantial portion, or all, of our revenues in future periods. Any material decrease in the overall level of sales or expected sales of, or the prices for, SDC or SDC-based products, whether as a result of competition, change in customer demand, or any other factor, would have a materially adverse effect on our business, financial condition and results of operations. We are marketing our new antimicrobial silver ion technology to industrial and consumer markets. These technologies and the products that incorporate them



have not yet been accepted into the marketplace, and may never be accepted. In addition, even if our products achieve market acceptance, we may not be able to maintain product sales or other forms of revenue over time if new products or technologies are introduced that are more favorably received than our products, are more cost-effective or otherwise render our products less attractive or obsolete.

We are subject to intense competition

Our SDC-based products compete in highly competitive markets dominated by prominent chemical and pharmaceutical companies. Most of our competitors have been in business for a longer period of time than us, have a greater number of products on the market and have greater financial and other resources than we do. Many of our competitors already have well established brands and distribution capabilities, and in some cases are able to leverage the sale of other products with more favorable terms for products competing with our own. We also have significantly fewer employees than virtually all of our competitors. Furthermore, recent trends in this industry are for large chemical and pharmaceutical companies to consolidate into a smaller number of very large entities, which further concentrates financial, technical and market strength and increases competitive pressure in the industry. If we directly compete with these very large entities for the same markets and/or products, their financial strength could prevent us from capturing a share of those markets. It is also possible that developments by our competitors will make our technologies or products noncompetitive or obsolete. Our ability to compete will depend upon our ability, and the ability of our distributors and other partners, to develop brand recognition and novel distribution methods, and to displace existing, established and future products in our relevant target markets. We, or our distributors and partners, may not be successful in doing so, which would have a materially adverse effect on our business, financial condition and results of operations.

We have limited sales, marketing and product distribution experience

We have limited experience in the sales, marketing and distribution of our products. While we previously relied primarily on product distribution arrangements and/or sales and marketing services provided by third parties, we have now developed and obtained EPA registration of our proprietary brand, PURE® Hard Surface disinfectant and food contact surface sanitizer, and have resumed direct control of our sales of this product through a restructuring of our sales strategy and operations. Our new sales and marketing strategy requires that we enact various operational changes in our business, including making significant investments in our own sales and marketing organization. We intend to market and sell our PURE Hard Surface and related SDC-based products into consumer, commercial and institutional markets through both traditional and alternative distribution channels. We have commenced the launch of a multi-channel national sales program, which involves our development of an internal team of industry sales experts to manage each of our key channels and our deployment of contract sales representative within each of those channels. Our current sales and marketing strategies and programs may not be successful, and we may not be able to establish the sales, marketing, and distribution capabilities necessary to directly control and manage these aspects of our operations. If we are not able to successfully sell, market and distribute these products directly, we may seek to establish product distribution arrangements with third parties, which may not be available on terms acceptable to us, if at all.

We expect to rely on third parties to develop SDC-based products, and they may not do so successfully or diligently

We rely in part, and expect to rely in the future, on third parties to whom we license rights to our technology to develop and commercialize products containing SDC for many of the applications for which we believe SDC-based products have, or may have, market opportunities.

Our reliance on these third parties for development activities reduces our control over these activities. In such arrangements, we have relied, and expect in the future to rely, on the third party to fund and direct product development activities and appropriate regulatory filings. Any of these third parties may not be able to successfully develop such SDC-based products due to, among other factors, a lack of capital, a lack of appropriate diligence, insufficient devotion to sales efforts, a change in the evaluation by the third party of the market potential for SDC-based products, technical failures, and poorer than expected results from testing or trial use of any products that may be developed. If the third parties on which we rely are not successful in such development activities, our business and operating results would be adversely affected.

If we are unable to successfully develop or commercialize new applications of our SDC technology, or if such efforts are delayed, our operating results will suffer

In addition to its use on inanimate surfaces, we are pursuing applications of our SDC technology as a broad-spectrum antimicrobial for use in human and veterinary healthcare products. Any product developed may be delayed or may never achieve regulatory approval or be commercialized. Delays in achieving regulatory approvals for particular applications of our products could significantly impact our product development costs. If indications are commercialized, we may not receive a share of future revenues that provides an adequate return on our historical or future investment.

If we are not able to manage any growth we achieve effectively, we may not become profitable

If our efforts to achieve and maintain market acceptance of our SDC technology are successful, we will need to expand our business operations. There can be no assurance that we will have sufficient resources to do. There also can be no assurance that if we continue to invest in additional infrastructure, we will be effective in expanding our operations or that our systems, procedures or controls will be adequate to support such expansion. In addition, we would need to provide additional sales and support services to our partners, potentially in multiple markets. Failure to

properly manage increased customer demands, if any, could result in a material adverse effect on customer satisfaction, our ability to meet our contractual obligations, and our operating results.

The industries in which we operate are heavily regulated and we may be unable to compete effectively

We are focused on the marketing and continued development of our SDC antimicrobial technology. We believe that all products derived from our SDC technology, or products that may be derived from our SDC technology in future periods, require or will require approval by government agencies prior to marketing or sale in the U.S. or in foreign markets. Complying with applicable government regulations and obtaining necessary approvals can be, and has historically been, time consuming and expensive, due in part, we believe, to the novel nature of our technology. Regulatory review could involve delays or other actions adversely affecting the development, manufacture, marketing and sale of our products. While we cannot accurately predict the outcome of any pending or future regulatory review processes or the extent or impact of any future changes to legislation or regulations affecting review processes, we expect such processes to remain time consuming and expensive as we, or our partners, apply for approval to make new or additional efficacy claims for current products or to market new product formulations. Obtaining approvals for new SDC-based products in the U.S., or in markets outside the U.S., could take several years, or may never be accomplished.

SDC is a platform technology rather than a single use applied technology. As such, products developed from the platform fall under the jurisdiction of multiple U.S. and international regulatory agencies. Our disinfectant and sanitizer products are regulated in the U.S. by the EPA. In addition to the EPA, each of the 50 United States has its own government agencies that regulate the sale or shipment of our products into their state. We have obtained registration for these products from the EPA and all states into which such products are currently marketed and sold. We are required to meet certain efficacy, toxicity and labeling requirements and pay ongoing fees in order to maintain such registrations. We may not be able to maintain these registrations in the future, which may eliminate our continued ability to market and sell our products in some or all parts of the U.S. We also may not be able to obtain necessary registrations with the EPA and applicable states for other SDC disinfectant and sanitizer products that we or our partners may develop, which would limit our ability to sell any such products in the future.

Some potential applications of SDC, such as those aimed at healthcare, veterinary and certain food preparation markets, may require approval of other government agencies prior to marketing or sale in the U.S. or in foreign markets, such as the FDA. Obtaining FDA approval is a complicated and expensive process and such approvals may never be obtained for any SDC products. If FDA approvals are obtained, the approvals may limit the uses for which SDC products may be marketed such that they may not be profitable to us, and the applicable products would be subject to pervasive and continuing regulation by the FDA that could lead to withdrawal of product approvals.

We intend to fund and manage certain of our EPA-regulated product development internally, in conjunction with our regulatory consultants and by partnering with other third parties. We have partnered, or intend to partner, with third parties who are seeking, or intend to seek, approvals to market SDC-based products in markets outside the U.S., and with other third parties who are developing FDA-regulated SDC-based products who, upon such development, would seek FDA approvals of such products. Our ability to market and sell our products is dependent on our and our partners' ability to obtain and maintain required registrations and approvals of applicable regulatory agencies. Failure by our partners or us to comply with applicable regulations could result in fines or the withdrawal of approval for us or our partners and distributors to market our products in some or all jurisdictions, which could cause us to be unable to successfully commercialize SDC or otherwise achieve revenues from sales of such products.

We are subject to substantial regulation related to quality standards applicable to our manufacturing and quality processes, and our failure to comply with applicable quality standards could affect our ability to commercialize SDC products

The EPA and other applicable U.S. and foreign government agencies regulate our and our partners' systems and processes for manufacturing SDC-based products. These regulations require that we and our partners observe "good manufacturing practices" in order to ensure product quality, safety and effectiveness. Failure by us or our partners to

comply with current or future government regulations and quality assurance guidelines could lead to temporary manufacturing shutdowns, product recalls or related field actions, product shortages, and/or delays in product manufacturing, any or all of which could cause significant cost to us. Further, efficacy or safety concerns and/or manufacturing quality issues with respect to our products or those of our partners could lead to product recalls, fines, withdrawal of approvals, and/or declining sales, any or all of which could result in our failure to successfully commercialize SDC or otherwise achieve revenue growth.

Pricing and supply issues may have a material impact on our margins and our ability to supply our customers

All of the supply ingredients used to manufacture our products are available from multiple suppliers. However, commodity prices for some ingredients can vary significantly and the margins that we are able to generate could decline if prices rise. For example, both silver and citric acid prices have been volatile in recent periods.

In addition to such commodities, for finished products we also rely on producers of specialized packaging inputs such as bottles and labels. Due to their specialized nature, the supply of such inputs can be periodically constrained, and result in additional costs to obtain these items, which may in turn inhibit our ability to supply products to our customers.

We are generally unable to raise our product prices to our customers, partners and distributors quickly to maintain our margins, and significant price increases for key inputs could therefore have an adverse effect on our results of operations. Price increases can also result in lost sales, and any inability to supply our customers' orders can lead to lost future sales to such customers.

While we expect to be the sole source supplier of SDC concentrate, in future periods we may use third parties to blend, package and provide fulfillment activities for our finished products. We expect that our margins would be reduced by using such third parties, and our ability to maintain product quality may not be as extensive or effective as when we produce these products in our own facility(ies). Any quality control issues could lead to product recalls and/or the loss of future sales, which would reduce our revenues and/or profits.

If we suffer negative publicity concerning the safety or efficacy of our products, our sales may be harmed

If concerns should arise about the safety or efficacy of any of our products that are marketed, regardless of whether or not such concerns have a basis in generally accepted science or peer-reviewed scientific research, such concerns could adversely affect the market for those products. Similarly, negative publicity could result in an increased number of product liability claims, whether or not those claims are supported by applicable law.

If a natural or man-made disaster strikes our manufacturing facility, we may be unable to manufacture our products for a substantial amount of time and our sales and profitability may decline

Our sole manufacturing facility and the manufacturing equipment we use to produce our products would be costly to replace and could require substantial lead-time to repair or replace. The facility may be affected by natural or man-made disasters and in the event they were affected by a disaster, we would be forced to set up alternative production capacity or rely on third party manufacturers to whom we would have to disclose our trade secrets. Although we possess insurance for damage to our property and the disruption of our business, such insurance may not be sufficient to cover all of our potential losses, may not continue to be available to us on acceptable terms, or at all, and may not address the marketing and goodwill consequences of our inability to provide products to meet customers' requirements.

If we are unable to obtain, maintain or defend patent and other intellectual property ownership rights relating to our technology, we or our collaborators and distributors may not be able to develop and market products based on our technology, which would have a material adverse impact on our results of operations

We rely and expect in the future to rely on a combination of patent, trademark, trade secret and copyright protections, as well as contractual restrictions, to protect the proprietary aspects of our technology and business.

Legal protections of our intellectual property and proprietary rights afford only limited protection. For instance, we currently own nine U.S. patents related to our SDC technology. The lives of these patents, and any patents that we may obtain in the future, are not indefinite, and the value to us of some or all of our patents may be limited by their terms. Further, although we have a number of U.S. and international patent applications pending, some or all of those applications may not result in issued patents, and the intellectual property claims therein would be unprotected. Additionally, obtaining and maintaining patent protection depends on our compliance with various procedural, document submission, fee payment and other requirements imposed by government patent agencies, and our patent protection could be reduced or eliminated for non-compliance with these requirements. Furthermore, legal standards relating to the validity, enforceability and scope of patent protection and protections of other intellectual property and proprietary rights in the U.S. are uncertain. Additionally, to the extent that we operate internationally, the laws of foreign countries may not protect our proprietary rights to the same extent as the laws of the U.S. For instance, many countries have a "first-to-file" trademark registration system, which may prevent us from registering or using our trademarks in certain countries if third parties have previously filed applications to register or have registered the same or similar trademarks. Additionally, changes in the patent and/or trademark laws or interpretations of such laws in the U.S. or other countries could diminish the value of our intellectual property rights. Moreover, our competitors may develop competing technologies that are not covered by the claims of, and therefore do not infringe upon, our issued patents, which could render our patents less valuable to us. If certain of our proprietary rights cannot be, or are not sufficiently, protected by patent and trademark registrations, it could have a material adverse impact on our business

and our ability to commercialize or license our technology and products.

Our own efforts to protect our intellectual property and other proprietary rights may also be insufficient. Despite efforts to protect our proprietary rights, including without limitation through confidentiality and other similar contractual restrictions, our means of protecting such rights may not be adequate and unauthorized parties may attempt to copy aspects of our proprietary technology, obtain and use information that we regard as proprietary, or otherwise misappropriate our intellectual property. In addition, unpatented proprietary rights, including trade secrets and know-how, can be difficult to protect and may lose their value if they are independently developed by a third party or if their secrecy is lost. It is possible that, despite our efforts, competitors or others will create and use products, adopt service names similar to our service names or otherwise violate or misappropriate our proprietary rights. The infringement of such rights could have a material negative impact on our business and on our results of operations.

Litigation may be necessary to enforce our intellectual property and other proprietary rights, which would be expensive and could consume time and other resources. The result of any such litigation may be the court's ruling that our patents or other intellectual property rights are invalid and/or should not be enforced. Additionally, even if the validity of such rights is upheld, the court could refuse to stop a third party's infringing activity on the ground that such activities do not infringe our rights. The U.S. Supreme Court has recently revised certain tests regarding granting patents and assessing the validity of patents to make it more difficult to obtain patents. As a consequence, issued patents may be found to contain invalid claims according to the newly revised standards. Some of our patents may be subject to challenge and subsequent invalidation or significant narrowing of claim scope in a reexamination proceeding, or during litigation, under the revised criteria.

Third parties may claim that we infringe their proprietary rights and may prevent us from manufacturing and selling some of our products

Our manufacture, use and sale of SDC-based products may subject us to lawsuits relating to the validity and infringement of patents or other proprietary rights of third parties. Litigation may be costly and time-consuming, and could divert the attention of our management and technical personnel. If we are found to have violated the trademark, trade secret, copyright, patent or other intellectual property or proprietary rights of others, such a finding could result in the need to cease use of a trademark, trade secret, copyrighted work or patented invention in our business and the obligation to pay a substantial amount for past infringement. If the rights holders are willing to permit us to continue to use their intellectual property rights, it may be necessary for us to enter into license arrangements with unfavorable terms and pay substantial amounts in royalty and other license fees. Either having to cease use or pay such fees could prevent us from manufacturing and selling our products, which could make us much less competitive in our industry and have a material adverse impact on our business, operating results and financial condition.

We may become subject to product liability claims

As a business that manufactures and markets products for use by consumers and institutions, we may become liable for any damage caused by our products, whether used in the manner intended or not. Regardless of merit or potential outcome, product liability claims against us may result in, among other effects, the inability to commercialize our products, impairment of our business reputation, and distraction of management's attention from our primary business. If we cannot successfully defend ourselves against product liability claims we could incur substantial liabilities. Although we maintain general and product liability insurance, our insurance may not cover potential claims and may not be adequate to indemnify for liabilities that may be imposed. Any imposition of liability that is not covered by insurance or is in excess of insurance coverage could harm our business and operating results.

Litigation or the actions of regulatory authorities may harm our business or otherwise distract our management

Substantial, complex or extended litigation could cause us to incur major expenditures and would distract our management. For example, lawsuits against us or our officers or directors by employees, former employees, stockholders, partners, customers, or others, or actions taken by regulatory authorities, could be very costly and substantially disrupt our business. Such lawsuits and actions are not uncommon, and we may not be able to resolve such disputes or actions on terms favorable to us, and there may not be sufficient capital resources available to defend such actions effectively, or at all.

Maintaining compliance with our obligations as a public company may strain our resources and distract management, and if we do not remain compliant our stock price may be adversely affected

Our common stock is registered under the Exchange Act. It is therefore subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act. Both the U.S. Congress and the SEC continue to issue new and proposed rules, and complying with existing and new rules has caused, and



will continue to cause, us to devote significant financial and other resources to maintain our status as a public company. In addition, in April 2008 we obtained a listing of our common stock on the NASDAQ Capital Market, adding the additional cost and administrative burden of maintaining such a listing. Such costs have been significantly increased since the commencement in September 2011 of a series of notices and a lengthy appeal process in connection with the potential delisting of our common stock from the NASDAQ Capital Market, which is described in further detail under the heading “Recent Developments” in Item 7 of this Annual Report. These additional regulatory costs and requirements will reduce our future profits or increase our future losses, and an increasing amount of management time and effort will be needed to meet our regulatory obligations.

We are required to evaluate our internal control systems in order to allow management to report on our internal controls as required by Section 404 of the Sarbanes-Oxley Act of 2002, and our management is required to attest to the adequacy of our internal controls. Recent SEC pronouncements suggest that in the next several years we may be required to report our financial results using new International Financial Reporting Standards, replacing GAAP, which would require us to make significant investments in training, hiring, consulting and information technology, among other investments. All of these and other reporting requirements and heightened corporate governance obligations that we face, or will face, will further increase the cost to us, perhaps substantially, of remaining compliant with our obligations under the Exchange Act and other applicable laws, including the Sarbanes-Oxley Act and the Dodd-Frank Act of 2010. In order to meet these incremental obligations, we will need to invest in our corporate and accounting infrastructure and systems, and acquire additional services from third party auditors and advisors. As a result of these requirements and investments, we may incur significant additional expenses and may suffer a significant diversion of management's time. There is no guarantee that we will be able to continue to meet these obligations in a timely manner. If we fail to do so, we could be subject to sanctions or investigation by regulatory authorities such as the SEC or the NASDAQ Stock Market and/or our common stock could be delisted. Any such actions could adversely affect the market price of our common stock, perhaps significantly.

Our publicly-filed reports are reviewed from time to time by the SEC, and any significant changes or amendments required as a result of any such review may result in material liability to us and may have a material adverse impact on the trading price of our common stock

The reports and other securities filings of publicly-traded companies are subject to review by the SEC from time to time for the purpose of assisting companies in complying with applicable disclosure requirements. The SEC is required, pursuant to the Sarbanes-Oxley Act of 2002, to undertake a comprehensive review of a company's reports at least once every three years, although an SEC review may be initiated at any time. While we believe that our previously filed SEC reports comply, and we intend that all future reports will comply, in all material respects with the published rules and regulations of the SEC, we could be required to modify, amend or reformulate information contained in our filings as a result of any SEC review. Any modification, amendment or reformulation of information contained in such reports could be significant and result in material liability to us and have a material adverse impact on the trading price of our common stock.

We are dependent on our management team

Our success depends largely upon the continued services of our executive officers and other key personnel. Our executive officers and key personnel could terminate their employment with us at any time without notice and without penalty.

We do not maintain key person life insurance policies on our executive officers or other employees, other than Michael L. Krall, our President, Chief Executive Officer and Interim Chief Financial Officer. The policy we have on Mr. Krall would likely not provide a benefit sufficient to offset the financial losses resulting from the loss of Mr. Krall's future services. The loss of one or more of our executive officers or key employees could seriously harm our business, results of operations, financial condition, and/or the market price of our common stock. We cannot assure you that in such an event we would be able to recruit qualified personnel able to replace these individuals in a timely manner, or at all, on terms acceptable to either us or to any qualified candidate.

In addition, on May 10, 2012, we announced that our former Chief Financial Officer, Craig Johnson, tendered his resignation from his position as our Chief Financial Officer. Mr. Johnson also previously served as our Principal Financial Officer and our Principal Accounting Officer. Mr. Johnson's last day at the Company was May 4, 2012. Effective May 11, 2012, Michael L. Krall was appointed as our Interim Chief Financial Officer, Principal Financial Officer and Principal Accounting Officer and will serve in such positions until a permanent Chief Financial Officer is appointed. This management transition could result in disruptions to our business and could cause our operations to

suffer.

Because competition for highly qualified business development and bioengineering personnel is intense, we may not be able to attract and retain the employees we need to support our planned growth

To successfully meet our objectives, we must continue to attract and retain highly qualified business development and bioengineering personnel with specialized skill sets focused on the industries in which we compete, or intend to compete. Competition for qualified business development and bioengineering personnel can be intense. Our ability to meet our business development objectives will depend in part on our ability to recruit, train and retain top quality people with advanced skills who understand our technology and business. In addition, it takes time for our new personnel to become productive and to learn our business. If we are unable to hire or retain qualified business development and bioengineering personnel, it will be difficult for us to sell our products or to license our technology, or to achieve or maintain regulatory approvals, and we may experience a shortfall in revenue and not achieve our anticipated, or any, growth.

16

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We anticipate significant changes to the composition of our Board of Directors in the near term

Effective July 9, 2012, we entered a settlement agreement in connection with the termination of the Richmond Litigation (as defined below) and the withdrawal of a proxy solicitation in favor of a slate of six nominees for election as directors on our Board at our 2012 annual meeting of stockholders held on July 31, 2012, all as described in further detail in Item 3 of this Annual Report. Pursuant to the terms of that settlement agreement, we are obligated to make good faith efforts to, within 12 months after the date of our 2012 annual meeting of stockholders, replace one member of our Board with a new independent director and add to our Board an additional independent director. In addition, one of our independent directors and a member of our Audit Committee and our Compensation Committee, Gregory Barnhill, unexpectedly died on September 14, 2012. Accordingly, we anticipate significant changes to the composition of our Board and the committees thereof in the near term. We may not be able to identify, attract and retain qualified and suitable candidates for our Board and certain Board committees who meet the requirements set forth in the settlement agreement and applicable SEC and NASDAQ listing rules in a timely manner or at all. If we are unable to do so, we could be subject to litigation relating to the settlement agreement or sanctions by applicable regulatory authorities, including without limitation the potential delisting of our common stock from the NASDAQ Capital Market. Further, even if we do identify and successfully attract new directors to sit on our Board, such transition in the composition of our Board and its committees could result in inefficiencies in Board activity, disagreements regarding our business models or other operational strategies, and disruptions to our business.

We may engage in strategic transactions that could impact our liquidity, increase our expenses and present significant distractions to our management

From time to time we may consider engaging in strategic transactions, such as acquisitions of companies, asset purchases and out-licensing or in-licensing of products, product candidates or technologies. Any such transaction may require us to incur non-recurring or other charges, may increase our near and long-term expenditures and may pose significant integration challenges or disrupt our management or business, which could adversely affect our operations and financial results. For example, these transactions may entail numerous operational and financial risks, including, among others, exposure to unknown liabilities, disruption of our business and diversion of our management's time and attention in order to develop acquired products, product candidates or technologies, difficulty and cost in combining the operations and personnel of any acquired businesses with our operations and personnel, and inability to retain key employees of any acquired businesses. Accordingly, although we may not choose to undertake or may not be able to successfully complete any transactions of the nature described above, any transactions that we do undertake or complete could have a material adverse effect on our business, results of operations, financial condition and prospects.

We may invest or spend our cash in ways with which you may not agree or in ways which may not yield a significant return

Our management has considerable discretion in the use of our cash. Our cash may be used for purposes that do not increase our operating results or market value. Until the cash is used, it may be placed in investments that do not produce significant income or that may lose value. The failure of our management to invest or spend our cash effectively could result in unfavorable returns and uncertainty about our prospects, each of which could cause the price of our common stock to decline.

We may not be able to utilize all, or any, of our tax net operating loss carry-forwards and our future after-tax earnings, if any, could be reduced

At July 31, 2012, we had federal and California tax net operating loss carry-forwards of approximately \$70.7 million and \$60.0 million, respectively. Utilization of these net operating loss carry-forwards may be subject to a substantial annual limitation due to ownership change limitations that may have occurred or that could occur in the future, as required by Section 382 of the Internal Revenue Code as well as similar state provisions. These ownership changes

may limit the amount of net operating loss carry-forwards that can be utilized annually to offset future taxable income and tax, respectively. In general, an ownership change, as defined by Section 382 of the Internal Revenue Code, results from a transaction or series of transactions over a three-year period resulting in an ownership change of more than 50 percentage points of the outstanding stock of a company by certain stockholders or public groups. Since our formation, we have raised capital through the issuance of capital stock on several occasions (both before and after our initial public offering in 1996) which, combined with the purchasing stockholders' subsequent disposition of those shares, may have resulted in such an ownership change, or could result in an ownership change in the future based upon subsequent disposition. While we believe that we have not experienced an ownership change, the pertinent tax rules related thereto are complex and subject to varying interpretations, and thus complete assurance cannot be provided that the taxing authorities would not take an alternative position.

Our current federal tax loss carry-forwards began expiring in the year ended July 31, 2011 and, unless previously utilized, will completely expire in the year ending July 31, 2031. In the years ending July 31, 2013 and 2014, \$1.9 million of our federal net operating loss carry-forwards will expire, and the balance of our current federal net operating loss carry-forwards will expire between July 31, 2018 and July 31, 2031. Our California tax loss carry-forwards will begin to expire in the year ending July 31, 2014, and will completely expire in the year ending July 31, 2031. If we are unable to earn sufficient profits to utilize the carry-forwards by these dates, they will no longer be available to offset future profits, if any.

We are subject to tax audits by various tax authorities in multiple jurisdictions

From time to time we may be audited by tax authorities to whom we are subject. Any assessment resulting from such audits, if any, could result in material changes to our past or future taxable income, tax payable or deferred tax assets, and could require us to pay penalties and interest that could materially adversely affect our financial results.

#### Risks Related to our Common Stock

The price of our common stock may be volatile, which may cause investment losses for our stockholders

The price and trading volume of our common stock have historically been volatile. For example, in the twelve months through October 24, 2012, the closing market price of our common stock ranged from \$0.99 per share to \$5.60 per share, and the monthly trading volume varied from approximately 298,000 shares to 11,042,000 shares. The market price of our common stock may continue to be volatile and could fluctuate substantially due to many factors, including, among others, the following:

- actual or anticipated fluctuations in our results of operations;
- the sale by us of our common or preferred stock or other securities, or the anticipation of sales of such securities;
- the trading volume of our common stock, particularly if such volume is light;
- the trading market of our common stock and our ability to maintain the listing of our common stock on a national securities exchange;
  - the introduction of new products or services, or product or service enhancements by us or our competitors;
- developments with respect to our or our competitors' intellectual property rights or regulatory approvals or denials;
  - announcements of significant acquisitions or other agreements by us or our competitors;
  - sales or anticipated sales of our common stock by our insiders (management and directors);
    - conditions and trends in our industry;
  - changes in our pricing policies or the pricing policies of our competitors;
  - changes in the estimation of the future size and growth of our markets; and
    - general economic conditions.

In addition, the stock market in general, the NASDAQ Capital Market, and the market for shares of novel technology and biotechnology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Further, the market prices of bioscience companies have been unusually volatile in the last year, and such volatility may continue for the foreseeable future. These broad market and industry factors may materially harm the market price of our common stock, regardless of our operating performance. In addition, this volatility could adversely affect an investor's ability to sell shares of our common stock, and/or the available price for such shares, at any given time.

Following periods of volatility in the market price of a company's securities, stockholder derivative lawsuits and securities class action litigation are common. Such litigation, if instituted against us or our officers and directors, could result in substantial costs and a diversion of management's attention and resources.

Potential future sales or issuances of our common stock to raise capital, or the perception that such sales could occur, could cause dilution to our current stockholders and the price of our common stock to fall

Although we are pursuing various sources of potential funding, we have historically supported our operations through the issuance of equity and expect to continue to do so in the future. Although we may not be successful in obtaining financing through equity sales on terms that are favorable to us, if at all, any such sales that do occur could result in substantial dilution to the interests of existing holders of our common stock. Additionally, the sale of a substantial number of shares of our common stock or other equity securities to any new investors, or the anticipation of such

sales, could cause the trading price of our common stock to fall.

We may not be able to maintain our NASDAQ listing

In April 2008, we obtained a listing for our common stock on the NASDAQ Capital Market. In order to maintain our listing, we must meet certain listing standards that include maintaining minimum thresholds of stockholders' equity, market value of our listed or publicly held securities, number of publicly held shares, bid price for our common stock, number of stockholders, number of market makers, and our net income. In addition, certain of our corporate governance policies are required to remain compliant with standards determined, and amended from time to time, by the NASDAQ Stock Market, or NASDAQ.

As previously disclosed in certain of our reports filed with the SEC, commencing in September 2011, we have received a series of deficiency letters from NASDAQ and undergone a lengthy appeal process with a NASDAQ Hearings Panel, or the Panel, relating to the potential delisting of our common stock from the NASDAQ Capital Market for noncompliance with several listing rules and standards. Although NASDAQ determined on September 21, 2012 that we had regained compliance with applicable listing standards and closed the matter of our delisting on that date, on October 1, 2012 we received an additional deficiency letter from NASDAQ notifying us of our noncompliance with NASDAQ listing rules related to audit committee membership requirements. Although NASDAQ has granted us a cure period in connection with our most recent noncompliance, we may not be able to regain or maintain our compliance with applicable NASDAQ requirements in the future and our securities could be delisted from the NASDAQ Capital Market. Such delisting could cause our common stock to be classified as “penny stock” and decrease the liquidity of our common stock, among other potentially detrimental consequences, any of which could significantly impact your ability to sell your shares of our common stock or to sell your shares at a price that you may deem to be acceptable. Further, should our securities fail to be listed on the NASDAQ Capital Market, our ability to attract new or certain types of investors and raise additional capital could be adversely affected, which could harm our business and financial condition.

Our recently effected one-for-eight reverse stock split has not resulted in a lasting increase in our stock price at an equivalent ratio

On August 14, 2012 and commencing with the opening of trading on August 15, 2012, we effected a one-for-eight reverse stock split of our outstanding shares of common stock. We effected the reverse stock split in large part to increase the per share price of our common stock in order to regain compliance with certain NASDAQ minimum bid price requirements. Although the trading price of our common stock increased by a corresponding ratio in the weeks immediately following the effectuation of the reverse stock split, as of October 24, 2012, the closing price of our common stock on the NASDAQ Capital Market had dropped to \$1.16. If the trading price of our common stock continues to decline, we could again be at risk for the delisting of our securities from the NASDAQ Capital Market due to our failure to satisfy NASDAQ’s \$1.00 per share minimum bid price requirement. Additionally, the decline in our stock price after the reverse stock split may materially reduce our ability to attract new investors in our securities, particularly institutional investors that are frequently subject to investment restrictions with respect to securities trading below a pre-established per share trading price. Further, the liquidity of our outstanding common stock may be adversely affected by the reverse stock split due to the one-for-eight reduction in the number of outstanding shares and the increase in our stock price at a significantly lesser ratio, which may impact your ability to sell your shares of our common stock at a price you consider acceptable.

We have never paid dividends on our capital stock, and we do not anticipate paying any cash dividends in the foreseeable future

The continued operation and expansion of our business will require substantial funding. Investors seeking cash dividends in the foreseeable future should not purchase our common stock. We have paid no cash dividends on any of our capital stock to date and we currently intend to retain our available cash to fund the development and growth of our business. Any determination to pay dividends in the future will be at the discretion of our Board and will depend upon results of operations, financial condition, contractual restrictions, restrictions imposed by applicable law and other factors our Board deems relevant. We do not anticipate paying any cash dividends on our common stock in the foreseeable future. Any return to stockholders will therefore be limited to the appreciation of their stock, which may never occur.

Anti-takeover provisions under our charter documents and Delaware law could delay or prevent a change of control and could also limit the market price of our stock



Certain provisions of our charter and bylaws may delay or frustrate the removal of incumbent directors and may prevent or delay a merger, tender offer, or proxy contest involving us that is not approved by our Board, even if such events may be beneficial to the interests of stockholders. For example, our Board, without stockholder approval, has the authority and power to authorize the issuance of up to 5,000,000 shares of preferred stock and such preferred stock could have voting or conversion rights which could adversely affect the voting power of the holders of our common stock. Further, the one-for-eight reverse stock split of our outstanding common stock that we recently effected has increased the proportion of unissued and authorized common shares to issued and outstanding common shares, which could allow our Board to issue large numbers of additional shares of our common stock that could significantly reduce the voting power of our current stockholders. In addition, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which may discourage, delay or prevent certain business combinations with stockholders owning 15% or more of our outstanding voting stock. These and other provisions in our charter documents may make it more difficult for stockholders or potential acquirers to initiate actions that are opposed by the then-current board of directors, including delaying or impeding a merger, tender offer, or proxy contest or other change of control transaction involving our company. Any delay or prevention of a change of control transaction could cause stockholders to lose a substantial premium over the then-current market price of their shares.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

We lease a facility in El Cajon, California covering a total of approximately 15,000 square feet. This is our primary facility and it includes our corporate offices, research and development laboratory, manufacturing operations and warehouse. Our current lease on this facility expires in December 2014. We also lease approximately 6,500 square feet of additional warehouse space. This facility is located within one mile of our primary facility. Our current lease on this facility expires in November 2012. We also lease other office and warehouse space on a month to month basis.

Item 3. Legal Proceedings

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. The impact and outcome of litigation, if any, is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. We are not currently aware of any such legal proceedings or claims to which we or our wholly owned subsidiary is a party or of which any of our property is subject that we believe will have, individually or in the aggregate, a material adverse effect on our business, financial condition or results of operations.

Settlement of Richmond Litigation

On June 29, 2011, we filed suit against Richmond Sciences, LLC in San Diego County Superior Court, Case No. 37-2011-00068549-CU-CO-EC, asserting various causes of action to collect on outstanding invoices. Richmond Sciences, LLC and Richmond Holdings, LLC then filed a cross-complaint for damages against us asserting contract, tort and statutory (trade secret) claims arising out of business dealings with us. We then filed a cross-complaint for compensatory and punitive damages against Richmond Sciences, LLC and Richmond Holdings, LLC asserting contract and fraud claims. We refer to our initial suit against Richmond Sciences, LLC and all related cross-claims as the "Richmont Litigation".

Additionally, prior to our 2012 annual meeting of stockholders held on July 31, 2012, a solicitation of proxies in favor of an opposing slate of six nominees for election as directors on our Board at that annual meeting had been initiated by The Coalition to Save Pure, or the Coalition, which consisted of Jeffrey P. Bash, Theodore J. Coburn, C. James Jensen, Dr. Martin Kassir, Thomas J. Reynolds, John P. Rochon and Richmont Corporation.

Effective as of July 9, 2012, we entered into a settlement agreement with the Coalition and with Richmond Sciences, LLC, Richmond Holdings, Inc., Richmont Corporation and IV-7 Direct, LLC, which we collectively refer to as "Richmont". Pursuant to the terms of the settlement agreement, all parties have dismissed all claims and cross-claims in the Richmont Litigation with prejudice, and Richmont and their respective affiliates, including John P. Rochon, have taken and have caused the Coalition to take all reasonable and necessary efforts to withdraw and not resubmit the Coalition's proxy solicitation in connection with our 2012 annual meeting of stockholders. In addition, the settlement agreement obligates us to make good faith efforts to, within 12 months after the date of our 2012 annual meeting of stockholders, replace one member of our Board with an independent director and add an additional independent director to our Board.

Item 4. Mine Safety Disclosures

Not applicable.



## PART II

## Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Information About Our Common Stock

Our common stock trades on the NASDAQ Capital Market under the symbol "PURE." Set forth below are the high and low sales prices for our common stock for each full quarterly period within the two most recent fiscal years, as adjusted for the one-for-eight reverse stock split effected August 14, 2012 and commencing with the opening of trading on August 15, 2012.

|                          | High   | Low    |
|--------------------------|--------|--------|
| Year Ended July 31, 2012 |        |        |
| First Quarter            | \$8.40 | \$5.04 |
| Second Quarter           | \$5.60 | \$2.56 |
| Third Quarter            | \$4.24 | \$1.78 |
| Fourth Quarter           | \$3.99 | \$2.00 |

|                          | High    | Low     |
|--------------------------|---------|---------|
| Year Ended July 31, 2011 |         |         |
| First Quarter            | \$24.40 | \$14.24 |
| Second Quarter           | \$24.54 | \$15.12 |
| Third Quarter            | \$17.76 | \$9.20  |
| Fourth Quarter           | \$12.00 | \$5.60  |

## Holders

As of October 24, 2012, we had approximately 171 holders of record of our common stock. This does not include beneficial owners holding common stock in street name.

## Dividend Policy

We have never paid dividends and have no current plans to do so. We currently anticipate that we will retain all of our future earnings, if any, for use in the development and expansion of our business and for general corporate purposes. Any determination to pay dividends in the future will be at the discretion of our Board and will depend upon our results of operations, financial condition and other factors that the Board, in its discretion, may deem relevant.

## Recent Sales of Unregistered Securities

On June 4, 2012, we issued an aggregate of 250,000 shares of our common stock to three separate investors pursuant to separate agreements entered with each such investor on May 16, 2012, May 17, 2012 and May 23, 2012. The shares were sold at a price of \$2.00 per share, resulting in approximately \$500,000 in aggregate proceeds to us. The shares have not been, nor will they be, registered under the Securities Act or any state securities laws and have been issued in reliance on an exemption from the registration requirements of the Securities Act afforded by Section 4(2) thereof based on the representation of each investor that it was an accredited investor; the absence of general solicitations or advertising to market the securities; the sale and issuance of securities in each case to only one investor; and the issuance of the securities as restricted securities.

## Repurchase of Equity Securities

None.

Information About Our Equity Compensation Plans

The information required under this heading is incorporated herein by reference to the applicable information set forth in Item 12 of this Annual Report on Form 10-K.

Item 6. Selected Financial Data

As a Smaller Reporting Company, as defined by Rule 12b-2 of the Exchange Act and in Item 10(f)(1) of Regulation S-K, we are electing scaled disclosure reporting obligations and therefore are not required to provide the information requested by this Item.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

All references to “PURE,” “we,” “our,” “us” and the “Company” in this Item 7 refer to Pure Bioscience, Inc. and our wholly owned subsidiary.

The discussion in this section contains forward-looking statements. These statements relate to future events or our future financial performance. We have attempted to identify forward-looking statements by terminology such as “anticipate,” “believe,” “can,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “potential,” “predict,” “show” or the negative of these terms or other comparable terminology, but their absence does not mean that a statement is not forward-looking. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, which could cause our actual results to differ from those projected in any forward-looking statements we make. Several risks and uncertainties we face are discussed in more detail under “Risk Factors” in Part I, Item 1A of this Annual Report or in the discussion and analysis below. You should, however, understand that it is not possible to predict or identify all risks and uncertainties and you should not consider the risks and uncertainties identified by us to be a complete set of all potential risks or uncertainties that could materially affect us. You should not place undue reliance on the forward-looking statements we make herein because some or all of them may turn out to be wrong. We undertake no obligation to update any of the forward-looking statements contained herein to reflect future events and developments, except as required by law. The following discussion should be read in conjunction with the consolidated financial statements and the notes to those statements included elsewhere in this Annual Report on Form 10-K.

Unless otherwise noted, all information in this Item 7 regarding share amounts of our common stock and prices per share of our common stock has been adjusted to reflect the application of the one-for-eight reverse stock split of our common stock that we effected on August 14, 2012, as further described below, on a retroactive basis.

Overview

Company Overview

We are focused on the discovery, development and commercialization of bioscience products that provide solutions to global health challenges. Our technology platform is based on stabilized ionic silver, and our initial products contain silver dihydrogen citrate, or SDC. SDC is a broad-spectrum, non-toxic antimicrobial. We manufacture and sell SDC-based disinfecting and sanitizing products, which are registered by the Environmental Protection Agency, or EPA, to distributors and end users. We also manufacture and sell various SDC-based formulations to manufacturers for use as a raw material in the production of personal care and other products. We believe our technology platform has potential application in a number of industries, and we have ongoing research and development projects in food processing, agriculture, water treatment, pharmaceuticals, and oil and gas.

Our goal is to become a sustainable company by using our proprietary technology platform to deliver leading antimicrobial products to multiple industries. We manufacture and sell SDC-based products for end use, products preserved with SDC and SDC as a raw material for manufacturing use. Our current products are as follows:

| Product Name                                | Product Use                | EPA Registration |
|---|----------------------------|------------------|
| PURE Complete System:<br>PURE® Hard Surface | Disinfectant and sanitizer | SDC3A            |

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|  |              |                |
|--|--------------|----------------|
| PURE Multi-Purpose Cleaner Concentrate | Cleaner      | Not applicable |
| PURE Floor Cleaner Concentrate         | Cleaner      | Not applicable |
| Axen® 30                               | Disinfectant | Axen30         |
| Axenohl®                               | Raw material | Axenohl        |
| Silvérion®                             | Raw material | Not applicable |

#### PURE Complete System

Our PURE Complete System is comprised of PURE® Hard Surface and our two new cleaning products that were launched as companion products to PURE Hard Surface, PURE Multi-Purpose Cleaner and PURE Floor Cleaner. The PURE Complete System offers a comprehensive, cost-effective and user-friendly product line to end-users, janitorial service providers and the distributors that supply them.

#### PURE® Hard Surface

PURE® Hard Surface is our patented and EPA-registered hard surface disinfectant and food contact surface sanitizer. We manufacture both consumer and commercial versions of the product. PURE Hard Surface combines high efficacy and low toxicity with 30-second bacterial and viral kill times and 24-hour residual protection. The product completely kills resistant pathogens such as MRSA and Carbapenem-resistant *Klebsiella pneumoniae* (NDM-1), and effectively eliminates dangerous fungi and viruses including HIV, Hepatitis B, Hepatitis C, Norovirus, Influenza A, Avian Influenza and H1N1. It also eradicates hazardous food pathogens such as *E. coli*, *Salmonella*, *Campylobacter* and *Listeria*. PURE Hard Surface delivers broad-spectrum efficacy yet remains classified as least-toxic by the EPA. The active ingredient, SDC, has been designated as Generally Recognized as Safe, or GRAS, for use on food processing equipment, machinery and utensils.

#### PURE Multi-Purpose and Floor Cleaner Concentrates

Our recently launched cleaning products, PURE Floor Cleaner and PURE Multi-Purpose Cleaner, are environmentally responsible cleaning products that are protected by SDC, a natural, non-toxic antimicrobial. SDC ensures the quality and safety of PURE Floor Cleaner and PURE Multi-Purpose Cleaner without human or environmental exposure to toxic chemical preservatives. PURE Floor Cleaner and PURE Multi-Purpose Cleaner are non-toxic and non-flammable and contain no EDTA, phosphates, ammonia or bleach as well as no VOCs or NPEs. PURE Floor Cleaner and PURE Multi-Purpose Cleaner provide professional strength cleaning in a concentrate formula that yields a 1:128 use dilution that is safe for use on all resilient surfaces.

#### Axen® 30

Axen®30 is our patented and EPA-registered hard surface disinfectant and is a predecessor product to PURE Hard Surface. Axen30 is sold by distributors under the private label brands SpectraSan24, PureGreen24, Critical Care, Mother Nature's Choice and Ag+ainst24. In prior years, we sold this product to other distributors that resold Axen30 under a variety of other private label brands.

#### Axenohl®

Axenohl® is our patented and EPA-registered antimicrobial formulation for use as a raw material in the manufacturing of EPA-registered products. Axenohl is a colorless, odorless and stable solution that provides fast acting efficacy against bacteria, viruses and fungi when manufactured into consumer and commercial disinfecting and sanitizing products.

#### Silvérion®

Silvérion® is our patented antimicrobial formulation for use as a raw material in the manufacturing of personal care products. It can be used as either an active ingredient or a preservative. Silvérion is a colorless, odorless and stable solution that provides ionic silver in a water-soluble form. It provides fast acting efficacy at low concentrations against a broad-spectrum of bacteria, viruses, yeast and molds.

We were incorporated in the state of California in August 1992 as Innovative Medical Services. In September 2003, we changed our name to Pure Bioscience. In March 2011, we reincorporated in the state of Delaware under the name "Pure Bioscience, Inc." We operate in one business segment.

#### Recent Developments



#### Reverse Stock Split

On August 13, 2012, we filed a Certificate of Amendment to our Certificate of Incorporation with the Secretary of State of the State of Delaware to effect a reverse stock split of our issued and outstanding common stock, \$0.01 par value per share, at a ratio of one-for-eight. The reverse stock split was approved by stockholders holding a majority of our outstanding voting power at our annual meeting of stockholders held on July 31, 2012. The reverse stock split became effective as of the close of trading on August 14, 2012 and shares of our common stock commenced trading on a post-reverse split basis as of the opening of trading on August 15, 2012, with each eight (8) issued and outstanding shares of our common stock automatically combined and converted into one (1) issued and outstanding share of our common stock. The reverse stock split affected all issued and outstanding shares of our common stock, as well as common stock underlying stock options, warrants, and convertible notes outstanding immediately prior to the effectiveness of the reverse stock split and the number of shares reserved for issuance under our equity incentive plan, but did not affect the number of authorized shares of our common stock. As a result of the reverse stock split, the number of outstanding shares of our common stock was reduced from approximately 57.8 million immediately prior to the effectiveness of the reverse stock split to approximately 7.2 million immediately thereafter.

### Common Stock Financings

On September 17, 2012, we closed an underwritten public offering of an aggregate of 4,341,615 shares of our common stock, including shares issued pursuant to the exercise of the underwriter's overallotment option, at a price to the public of \$1.10 per share for net proceeds to us of approximately \$4,313,000 (after deducting underwriting discounts and commissions and other offering expenses, although before payment of certain other legal and accounting expenses). The offering was made pursuant to our registration statement on Form S-3 (Registration No. 333-182475), which became effective on July 31, 2012, and a preliminary and final prospectus supplement filed with the Securities Exchange Commission, or the SEC, on September 4, 2012 and September 13, 2012, respectively. The shares were sold pursuant to an underwriting agreement between us and Aegis Capital Corp.

On June 29, 2012, we entered into a common stock purchase agreement with fifteen investors, pursuant to which we issued and sold to such investors an aggregate of 325,125 shares of our common stock and warrants to purchase up to an aggregate of 81,280 shares of our common stock. The shares were sold to the investors at a price of \$2.00 per share, resulting in gross proceeds to us of approximately \$650,000. The warrants issued to such investors have a three-year term, become exercisable six months after the date of their issuance, and have an exercise price of \$3.52 per common share, subject to adjustment as set forth in the warrants. The investors have certain piggyback registration rights with respect to the shares sold pursuant to the common stock purchase agreement, the warrants and the shares issuable upon exercise of the warrants, which rights are subject to certain conditions and limitations set forth in such agreement. None of the securities sold to such investors have been registered under the Securities Act or any state securities laws and have been issued in reliance on an exemption from the registration requirements of the Securities Act afforded by Section 4(2) thereof and Regulation D promulgated thereunder.

On June 4, 2012, we issued an aggregate of 250,000 shares of our common stock to three separate investors pursuant to separate agreements entered with each such investor on May 16, 2012, May 17, 2012 and May 23, 2012. The shares were sold at a price of \$2.00 per share, resulting in approximately \$500,000 in aggregate gross proceeds to us. The shares have not been, nor will they be, registered under the Securities Act or any state securities laws and have been issued in reliance on an exemption from the registration requirements of the Securities Act afforded by Section 4(2) thereof.

### Bridge Loan

Pursuant to a securities purchase agreement entered into on June 26, 2012, on July 10, 2012 we received an aggregate of \$1,200,000 in cash consideration from nine lenders in exchange for our issuance to such lenders of secured convertible promissory notes, or the Notes, in an aggregate principal amount of \$1,333,000. We refer to such transaction herein as the "Bridge Loan". Pursuant to the terms of the Notes and the other agreements (as amended) entered in connection with the Bridge Loan, or the Loan Agreements, all amounts owed thereunder became due and payable upon our closing of our underwritten public offering on September 17, 2012, and accordingly such amounts have been repaid in accordance with such terms.

The Notes had an interest rate of 0% during their term, subject to certain late fee and interest charges if they were not repaid when they became due. The Notes were secured by a lien on all of our assets pursuant to a security agreement entered in connection with the Bridge Loan, which security interest has been terminated pursuant to our repayment of all amounts owed. The Notes were also secured by 575,000 shares of our common stock (later reduced to 500,000 shares pursuant to an amendment effective September 6, 2012), which shares were issued in the name of an escrow agent as additional collateral for the timely repayment of the Notes and will be cancelled pursuant to our full repayment of the Bridge Loan. The Notes were convertible into shares of our common stock at the option of the lenders if all amounts owed thereunder were not paid in accordance with the terms of the Notes and the other Loan Agreements.

As further consideration to the lenders for the Bridge Loan in addition to our issuance of the Notes, we issued to each such lenders: (i) an aggregate amount of 54,878 shares of our common stock and (ii) warrants to acquire up to an

aggregate amount of 128,046 shares of our common stock, which warrants have a four-year term, become exercisable six months after the date of their issuance, and currently have an as-adjusted exercise price equal to \$1.023 per share (subject to certain additional adjustments as set forth in such warrants).

Additionally, for services provided in conjunction with Bridge Loan, we issued to the placement agent for the Bridge Loan: (i) an aggregate amount of 625 shares of our common stock and (ii) warrants to acquire up to an aggregate amount of 4,374 shares of our common stock, which warrants have a four-year term, become exercisable six months after the date of their issuance, and currently have an as-adjusted exercise price equal to \$1.023 per share (subject to certain additional adjustments as set forth in such warrants).

Total fees associated with the Bridge Loan were \$267,000. Of that amount, \$166,000 relates to the fair value of 54,878 shares of common stock issued to the lenders, and \$2,000 relates to the fair value of 625 shares of common stock issued to the placement agent for the Bridge Loan.

### NASDAQ Delisting

As previously disclosed in certain of our reports filed with the SEC, commencing in September 2011, we have received a series of deficiency letters from the NASDAQ Stock Market, or NASDAQ, and have undergone a lengthy appeal process with a NASDAQ Hearings Panel, or the Panel, relating to the potential delisting of our common stock from the NASDAQ Capital Market for noncompliance with several listing rules and standards. After receiving several letters from the Panel granting our continued listing contingent upon our satisfaction of certain specified conditions, on September 21, 2012, we received a final decision letter notifying us that the NASDAQ Listing Qualifications Staff had concluded that we had satisfied the required conditions and regained compliance with all applicable listing requirements, and accordingly had determined to continue the listing of our securities on the NASDAQ Capital Market and to close the matter of our delisting on that date.

On October 1, 2012, we received a new deficiency letter from NASDAQ regarding our noncompliance with NASDAQ's audit committee membership requirements as a result of the death of our former director and Audit Committee member Gregory Barnhill. Consistent with applicable NASDAQ listing rules, NASDAQ has granted us the following cure period to regain compliance with NASDAQ's audit committee membership requirements: (i) until the earlier of our next annual meeting of stockholders or September 14, 2013, or (ii) if our next annual meeting of stockholders is held before March 13, 2013, until March 13, 2013. We intend to appoint an independent director who satisfies NASDAQ's requirements for membership on our Audit Committee as promptly as practicable to rectify this noncompliance.

### Settlement Agreement

On June 29, 2011, we filed suit against Richmond Sciences, LLC in San Diego County Superior Court, Case No. 37-2011-00068549-CU-CO-EC, asserting various causes of action to collect on outstanding invoices. Richmond Sciences, LLC and Richmond Holdings, LLC then filed a cross-complaint for damages against us asserting contract, tort and statutory (trade secret) claims arising out of business dealings with us. We then filed a cross-complaint for compensatory and punitive damages against Richmond Sciences, LLC and Richmond Holdings, LLC asserting contract and fraud claims. Our initial suit against Richmond Sciences, LLC and all related cross-claims are referred to herein as the "Richmont Litigation".

Additionally, prior to our 2012 annual meeting of stockholders held on July 31, 2012, a solicitation of proxies in favor of an opposing slate of six nominees for election as directors on our Board at that annual meeting had been initiated by The Coalition to Save Pure, or the Coalition, which consisted of Jeffrey P. Bash, Theodore J. Coburn, C. James Jensen, Dr. Martin Kassir, Thomas J. Reynolds, John P. Rochon and Richmont Corporation.

Effective as of July 9, 2012, we entered into a settlement agreement with the Coalition and with Richmond Sciences, LLC, Richmond Holdings, Inc., Richmond Corporation and IV-7 Direct, LLC, which we collectively refer to as "Richmont". Pursuant to the terms of the settlement agreement, all parties have dismissed all claims and cross-claims in the Richmont Litigation with prejudice, and Richmont and their respective affiliates, including John P. Rochon, have taken and have caused the Coalition to take all reasonable and necessary efforts to withdraw and not resubmit the Coalition's proxy solicitation in connection with our 2012 annual meeting of stockholders. In addition, the settlement agreement obligates us to make good faith efforts to, within 12 months after the date of our 2012 annual meeting of stockholders, replace one member of our Board with an independent director and add an additional independent director to our Board.

### Financial Overview

This financial overview provides a general description of our revenue and expenses.

### Revenue

We manufacture and sell SDC-based products for end use, and as a raw material for manufacturing use. We also license our products and technology to development and commercialization partners. Revenue is recognized when

realized or realizable and earned. Any amounts received prior to satisfying revenue recognition criteria are recorded as deferred revenue.

#### Cost of Goods Sold

Cost of goods sold for product sales includes direct and indirect costs to manufacture products, including materials consumed, manufacturing overhead, shipping costs, salaries, benefits and related expenses of operations. Depreciation related to manufacturing is systematically allocated to inventory produced, and expensed through cost of goods sold at the time inventory is sold.

#### Selling, General and Administrative

Selling, general and administrative expense consists primarily of salaries and other related costs for personnel in business development, sales, finance, accounting, information technology, and executive functions. Other selling, general and administrative costs include product marketing, advertising, and trade show costs, as well as public relations and investor relations, facility costs, and legal, accounting and other professional fees.

**Research and Development**

Our research and development activities are focused on leveraging our technology platform to develop additional proprietary products and applications. Research and development expense consists primarily of personnel and related costs, product registration expenses, and third-party testing. We expense research and development costs as incurred.

**Other Income (Expense)**

We record interest income, interest expense, change in derivative liabilities, as well as other non-operating transactions, as other income (expense) in our consolidated statements of operations.

## Results of Operations – Comparison of the Years Ended July 31, 2012 and 2011

### Fluctuations in Operating Results

Our results of operations have fluctuated significantly from period to period in the past and are likely to continue to do so in the future. We anticipate that our results of operations will be affected for the foreseeable future by several factors that may contribute to these periodic fluctuations, including the demand for our products, the timing and amount of our product sales, and the progress and timing of expenditures related to sales and marketing, as well as product development. Due to these fluctuations, we believe that the period-to-period comparisons of our operating results are not a reliable indication of our future performance.

### Net Product Sales

Net product sales were \$812,000 and \$454,000 for the years ended July 31, 2012 and 2011, respectively. The increase of \$358,000 was primarily attributable to sales to one customer, as well as increased sales to several other customers. Our top two customers accounted for \$547,000 of net product sales for the year ended July 31, 2012.

For the year ended July 31, 2012, two individual customers accounted for 67% of our net product sales. No other individual customer accounted for 10% or more of our net product sales. The geographic breakdown of net product sales was as follows: 92% U.S. and 8% foreign.

For the year ended July 31, 2011, one customer accounted for 46% of our net product sales. No other individual customer accounted for 10% or more of our net product sales. The geographic breakdown of net product sales was as follows: 87% U.S. and 13% foreign.

### Cost of Goods Sold

Cost of goods sold was \$264,000 and \$131,000 for the years ended July 31, 2012 and 2011, respectively. The increase of \$133,000 was attributable to increased net product sales, as well as an inventory charge. The inventory charge represents costs incurred by us to rework certain finished goods inventory, as well as a write-off of certain packaging inventory.

Gross margin as a percentage of net product sales, or gross margin percentage, was 67% and 71% for the years ended July 31, 2012 and 2011, respectively. Gross margin percentage, excluding the inventory charge noted above, was 75% and 71% for the years ended July 31, 2012 and 2011, respectively. The decrease in gross margin percentage was primarily attributable to the sale of lower margin formulations and packaging configurations of our products during the year ended July 31, 2012 as compared to prior year.

### Selling, General and Administrative Expense

Selling, general and administrative expense was \$7,439,000 and \$6,520,000 for the years ended July 31, 2012 and 2011, respectively. The increase of \$919,000 was primarily attributable to an increase in legal fees, which were incurred as a result of litigation with Richmond Sciences LLC as well as the proxy contest that Richmond Corporation initiated, and increases in personnel and related costs. The increases were partially offset by reduced depreciation, amortization, and stock option expense.

### Research and Development Expense

Research and development expense was \$1,863,000 and \$2,180,000 for the years ended July 31, 2012 and 2011, respectively. The decrease of \$317,000 was primarily attributable to decreases in personnel and related costs, third-party research and testing activities, laboratory supplies and patent costs. These decreases were partially offset by increased stock option expense.

### Change in Derivative Liability

Change in derivative liability for the years ended July 31, 2012 and 2011 was \$11,000 and zero respectively. The increase is due to the issuance of warrants with anti-dilution provisions during the year ended July 31, 2012 and the conversion features associated with the secured convertible promissory notes that we issued in July 2012 in connection with the Bridge Loan.

#### Interest Expense

Interest expense for the year ended July 31, 2012 was \$145,000 compared to zero for the year ended July 31, 2011. The increase in interest expense during the year ended July 31, 2012 is primarily attributable to non-cash amortization of debt discounts related to the secured convertible promissory notes that we issued in July 2012 in connection with the Bridge Loan.

#### Interest Income

Interest income was \$1,000 and \$8,000 for the years ended July 31, 2012 and 2011, respectively. The decrease was primarily attributable to lower cash balances in the year ended July 31, 2012.



#### Other (Expense) Income, net

Other expense, net was \$3,000 for the year ended July 31, 2012, compared to other income, net of \$10,000 for the year ended July 31, 2011. The decrease of \$13,000 was primarily attributable to a settlement amount of \$13,000 that we received in the year ended July 31, 2011.

#### Liquidity and Capital Resources

Since our inception, we have financed our operations primarily through public and private offerings of securities, revenue from product sales and license agreements, proceeds from the sale of a division and interest income from invested cash balances. We have a history of recurring losses, and we have incurred a cumulative net loss of \$62,500,000.

On September 17, 2012, we closed an underwritten public offering of an aggregate of 4,341,615 shares of our common stock, including shares issued pursuant to the exercise of the underwriter's overallotment option, at a price to the public of \$1.10 per share for net proceeds to us of approximately \$4,313,000 (after deducting underwriting discounts and commissions and other offering expenses, although before payment of certain other legal and accounting expenses).

Pursuant to a securities purchase agreement entered into on June 26, 2012, on July 10, 2012 we received an aggregate of \$1,200,000 in cash consideration from nine lenders in exchange for our issuance to such lenders of Notes in an aggregate principal amount of \$1,333,000 in the Bridge Loan transaction. Pursuant to the terms of the Loan Agreements, all amounts owed thereunder became due and payable upon our closing of our underwritten public offering on September 17, 2012, and accordingly such amounts have been repaid in accordance with such terms.

On June 29, 2012, we entered into a common stock purchase agreement with fifteen investors, pursuant to which we issued and sold to such investors an aggregate of 325,125 shares of our common stock and warrants to purchase up to an aggregate of 81,280 shares of our common stock. The shares were sold to the investors at a price of \$2.00 per share, resulting in gross proceeds to us of approximately \$650,000.

On June 4, 2012, we issued an aggregate of 250,000 shares of our common stock to three separate investors pursuant to agreements entered with each such investor on May 16, 2012, May 17, 2012 and May 23, 2012. The shares were sold at a price of \$2.00 per share, resulting in approximately \$500,000 in aggregate gross proceeds to us.

On December 14, 2011 and December 15, 2011, we entered into two purchase agreements and a registration rights agreement with Lincoln Park for potential future sales of our common stock totaling up to \$10,000,000 from time to time during the terms of the purchase agreements. The provisions of such agreements are described in more detail in Note 8 of our consolidated financial statements in Part II, Item 8 of this Annual Report. On May 18, 2012, we delivered notice to Lincoln Park of our termination of both purchase agreements and, consequently, since the date of the notice there have been, and there will be, no further sales of our common stock to Lincoln Park under those agreements. During the year ended July 31, 2012, we sold 718,463 shares of our common stock to Lincoln Park under one of the purchase agreements for net proceeds to us of \$1,719,000. All such shares were registered under our then-effective shelf registration statement previously filed with the SEC, which expired on May 8, 2012.

In April 2011, we entered into a sales agreement with an investment banking firm. Under the terms of the sales agreement, we were permitted to offer and sell shares of our common stock having an aggregate offering price of up to \$7,000,000. The sales were made, from time to time, through the investment bank in "at the market" offerings as defined by the SEC and were made pursuant to our then-effective shelf registration statement previously filed with the SEC, which expired on May 8, 2012. During the year ended July 31, 2012, we sold 167,136 shares of our common stock under the sales agreement for net proceeds to us of \$949,000, and during the year ended July 31, 2011, we sold 329,571 shares of our common stock under the sales agreement for net proceeds to us of \$3,065,000. Effective as of December 14, 2011, we terminated the sales agreement and, as a result of such termination, there have been no sales

of our common stock under the sales agreement since the date of its termination and there will be no future sales of our common stock under the sales agreement.

In October 2010, we completed a private placement of 135,000 newly issued unregistered shares of our common stock at a price of \$17.60 per share. The net proceeds from the private placement were \$2,367,000.

During the year ended July 31, 2012, there were no exercises of stock options or warrants. During the year ended July 31, 2011, we received \$278,000 from the issuance of common stock upon the exercise of stock options. We also received \$259,000 from the issuance of common stock upon the exercise of warrants during that annual period.

As of July 31, 2012, we had \$877,000 in cash and cash equivalents, and \$373,000 in accounts receivable, compared to \$1,794,000 in cash and cash equivalents, and \$50,000 in accounts receivable as of July 31, 2011. The net decrease in cash and cash equivalents was primarily attributable to the use of cash to fund our operations, partially offset by proceeds from the issuance of common stock through securities offerings and the funds received in connection with the Bridge Loan (which amounts have since been repaid). The increase in accounts receivable was attributable to higher product sales for the year ended July 31, 2012 as compared to prior year. Additionally, as of July 31, 2012, we had \$3,637,000 of current liabilities, and \$1,946,000 in accounts payable, compared to \$935,000 of current liabilities, and \$677,000 in accounts payable as of July 31, 2011. The net increase in current liabilities and accounts payable was primarily attributable to the Bridge Loan, as well as to increased legal fees, which were incurred as a result of litigation with Richmond Sciences, LLC, and the proxy contest that Richmond Corporation initiated.

The following table summarizes our contractual obligations as of July 31, 2012.

|                             | Total      | Payments due by period |            |           |                      |
|-----------------------------|------------|------------------------|------------|-----------|----------------------|
|                             |            | Less than<br>1 year    | 1-3 years  | 3-5 years | More than 5<br>years |
| Operating lease obligations | \$ 389,000 | \$ 150,000             | \$ 239,000 | -         | -                    |
| Total                       | \$ 389,000 | \$ 150,000             | \$ 239,000 | -         | -                    |

In addition, from time to time we have entered into employment agreements with our executives that, under certain cases, provide for the continuation of salary and certain other benefits if these executives are terminated under specified circumstances. These agreements generally expire upon termination for cause or when we have met our obligations under these agreements. As of July 31, 2012, no events have occurred resulting in the obligation of any such payments.

Our future capital requirements depend on numerous forward-looking factors. These factors may include, but are not limited to, the following: the acceptance of, and demand for, our products; our success and the success of our partners in selling our products; our success and the success of our partners in obtaining regulatory approvals to sell our products; the costs of further developing our existing products and technologies; the extent to which we invest in new product and technology development; and the costs associated with the continued operation, and any future growth, of our business. The outcome of these and other forward-looking factors will substantially affect our liquidity and capital resources.

We expect that we will need to increase our liquidity and capital resources by one or more measures. These measures may include, but are not limited to, the following: reducing operating expenses; obtaining financing through the issuance of equity, debt, or convertible securities; entering into partnerships, licenses, or other arrangements with third parties; and reducing the exercise price of outstanding warrants. Any one of these measures could substantially reduce the value to us of our technology and its commercial potential. If we issue equity, debt or convertible securities to raise additional funds, our existing stockholders may experience dilution, and the new equity, debt or convertible securities may have rights, preferences and privileges senior to those of our existing stockholders. There is no guarantee that we would be able to obtain capital on terms acceptable to us, or at all.

If we are unable to obtain sufficient capital, it would have a material adverse effect on our business and operations. It could cause us to fail to execute our business plan, fail to take advantage of future opportunities, or fail to respond to competitive pressures or customer requirements. It also may require us to delay, scale back or eliminate some or all of our research and development programs, to license to third parties the right to commercialize products or technologies that we would otherwise commercialize ourselves, or to reduce or cease operations altogether. If adequate funds are not available when needed, we may be required to significantly modify our business model and operations to reduce spending to a sustainable level.

We believe our current efforts to raise capital, our current efforts to market and sell our products, and our ability to significantly reduce expenses, will provide sufficient cash resources to satisfy our needs over the next 12 months. However, we do not yet have, and we may never have, significant cash inflows from product sales or from other sources of revenue to offset our ongoing and planned investments in corporate infrastructure, research and development projects, regulatory submissions, business development initiatives, and sales and marketing activities, among other investments. Some or all of our ongoing or planned investments may not be successful and could result in further losses. In addition, irrespective of our cash resources, we may be contractually or legally obligated to make certain investments which cannot be postponed.

#### Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based on our audited consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosures. We evaluate our estimates on an ongoing basis. We base our estimates on historical experience and on other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following accounting policies and estimates are critical to aid you in understanding and evaluating our reported financial results.

#### Revenue Recognition

We sell our products to distributors and end users. We record revenue when we sell products to our customers, rather than when our customers resell products to third parties. When we sell products to our customers, we reduce the balance of our inventory with a corresponding charge to cost of goods sold. We do not currently have any consignment sales.

Product sales are recognized when delivery of the products has occurred, title has passed to the customer, the selling price is fixed or determinable, collectability is reasonably assured and we have no further obligations. Any amounts received prior to satisfying these revenue recognition criteria are recorded as deferred revenue. We record product sales net of discounts at the time of sale and report product sales net of such discounts.

We also license our products and technology to development and commercialization partners. License fee revenue consists of product and technology license fees earned. Upfront product and technology license fees under multiple-element arrangements are deferred and recognized over the period of such services or performance, if such arrangements require on-going services or performance. Non-refundable amounts received for substantive milestones are recognized upon achievement of the milestone. Any amounts received prior to satisfying these revenue recognition criteria are recorded as deferred revenue.

#### Share-Based Compensation

We grant equity-based awards under share-based compensation plans. We estimate the fair value of share-based payment awards using the Black-Scholes option valuation model. This fair value is then amortized over the requisite service periods of the awards. The Black-Scholes option valuation model requires the input of subjective assumptions, including price volatility of the underlying stock, risk-free interest rate, dividend yield, and expected life of the option. Share-based compensation expense is based on awards ultimately expected to vest, and therefore is reduced by expected forfeitures. Changes in assumptions used under the Black-Scholes option valuation model could materially affect our net loss and net loss per share.

#### Impairment of Long-Lived Assets

In accordance with GAAP, if indicators of impairment exist, we assess the recoverability of the affected long-lived assets by determining whether the carrying value of such assets can be recovered through undiscounted future operating cash flows. If impairment is indicated, we measure the amount of such impairment by comparing the carrying value of the asset to the fair value of the asset and we record the impairment as a reduction in the carrying value of the related asset and a charge to operating results. Estimating the undiscounted future cash flows associated with long-lived assets requires judgment, and assumptions could differ materially from actual results.

For purposes of testing impairment, we group our long-lived assets at the lowest level for which there are identifiable cash flows independent of other asset groups. Currently, there is only one level of aggregation for our intangible assets. We assess the impairment of long-lived assets, consisting of property, plant, and equipment and our patent portfolio, whenever events or circumstances indicate that the carrying value may not be recoverable. Examples of such events or circumstances include:

- an asset group's ability to continue to generate income from operations and positive cash flow in future periods;
  - loss of legal ownership or title to an asset;
- significant changes in our strategic business objectives and utilization of the asset(s); and
  - the impact of significant negative industry or economic trends.

Additionally, on a quarterly basis we review the significant assumptions underlying our impairment assessment to determine that our previous conclusions remain valid.

Recoverability of assets to be held and used in operations is measured by a comparison of the carrying amount of an asset to the future net cash flows expected to be generated by the assets. The factors used to evaluate the future net cash flows, while reasonable, require a high degree of judgment and the results could vary if the actual results are materially different than the forecasts. In addition, we base useful lives and amortization or depreciation expense on our subjective estimate of the period that the assets will generate revenue or otherwise be used by us. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less selling costs.

We also periodically review the lives assigned to our intangible assets to ensure that our initial estimates do not exceed any revised estimated periods from which we expect to realize cash flows from the technologies. If a change were to occur in any of the above-mentioned factors or estimates, the likelihood of a material change in our reported results would increase.

#### Derivative Financial Instruments

We do not use derivative instruments to hedge exposures to cash flow or market or foreign currency risks.

We review the terms of the common stock, warrants and convertible debt we issue to determine whether there are derivative instruments, including embedded conversion options that are required to be bifurcated and accounted for separately as derivative financial instruments. In circumstances where the host instrument contains more than one embedded derivative instrument, including a conversion option, that is required to be bifurcated, the bifurcated derivative instruments are accounted for as a single, compound derivative instrument.

Derivatives are initially recorded at fair value and are then revalued at each reporting date with changes in the fair value reported as non-operating income or expense. When the equity or convertible debt instruments contain embedded derivative instruments that are to be bifurcated and accounted for as liabilities, the total proceeds received are first allocated to the fair value of all the bifurcated derivative instruments. The remaining proceeds, if any, are then allocated to the host instruments themselves, usually resulting in those instruments being recorded at a discount from their face value.

#### Recent Accounting Pronouncements

No recent accounting pronouncements or other authoritative guidance have been issued that management considers likely to have a material impact on our consolidated financial statements.

#### Off Balance Sheet Arrangements

We do not have any off balance sheet arrangements.

#### Item 7A. Quantitative and Qualitative Disclosures About Market Risk

As a Smaller Reporting Company as defined by Rule 12b-2 of the Exchange Act and in Item 10(f)(1) of Regulation S-K, we are electing scaled disclosure reporting obligations and therefore are not required to provide the information requested by this Item.

#### Item 8. Consolidated Financial Statements and Supplementary Data

The consolidated financial statements and supplementary data required by this Item 8 are set forth at the end of this Annual Report.

#### Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Interim Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

As required by Rule 13a-15(b) under the Exchange Act, our management conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and our Interim Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Annual Report. Based on the foregoing evaluation, our principal executive officer and principal financial officer concluded that as of the end of the period covered by this report our disclosure controls and procedures were effective.

Changes in Our Controls

There were no changes in our internal controls over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Exchange Act Rules 13a-15(f) and 15d-15(f). With the participation of our Chief Executive Officer and Interim Chief Financial Officer, management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its evaluation under this framework, our management concluded that our internal control over financial reporting was effective as of July 31, 2012.

Item 9B. Other Information

Not applicable.



## PART III

## Item 10. Directors, Executive Officers and Corporate Governance

## Information Regarding the Board of Directors

Pursuant to our bylaws, the number of directors is fixed and may be increased or decreased from time to time by resolution of our Board of Directors, or the Board. The Board has fixed the number of directors at six members. Due to the unexpected death of one of our directors, Gregory H. Barnhill, on September 14, 2012, there is currently one vacancy on our Board. Vacancies on the Board may be filled by a majority of the directors then in office or by a sole remaining director. As of the date of our filing of this Annual Report, we have not filled the vacant seat on our Board or any committees thereof caused by Mr. Barnhill's death. Mr. Barnhill was also a member of the Audit Committee and the Compensation Committee of our Board. We intend to appoint one or more independent directors to our Board and those committees who satisfy all applicable qualifications and other requirements therefor as promptly as practicable.

Information with respect to our current directors is shown below.

| Name                | Age | Director Since | Position(s) Held                                |
|---------------------|-----|----------------|---|
| Dennis Brovarone    | 56  | 1996           | Director  |
| John J. Carbone, MD | 50  | 2009           | Director  |
| Michael L. Krall    | 60  | 1992           | President, CEO, Interim CFO, Chairman, Director |
| Paul V. Maier       | 64  | 2008           | Director  |
| Donna Singer        | 42  | 1998           | Executive Vice President, Director              |

**Dennis Brovarone** Mr. Brovarone has been practicing corporate and securities law since 1986 and as a sole practitioner since 1990, specializing in U.S. public companies. He was elected to the Board in April 1996, and acted as counsel to the Company at the time of our initial public offering in that year. Mr. Brovarone has served as securities counsel to the Company since that time. We believe and have concluded that Mr. Brovarone's extensive knowledge of U.S. securities law and capital markets, experience in strategic transactions and mergers and acquisitions, technical skills across various industries, and deep understanding of our business and operations which he has acquired through his more than sixteen years of service to the Company make him a qualified and suitable director on our Board.

**John J. Carbone, MD** Dr. Carbone is a Board Certified Orthopedic Surgeon and a Fellow of the American Academy of Orthopedic Surgeons. Since 2004, he has served as the Director, Orthopedic Spine Services at Harbor Hospital in Baltimore, Maryland. Dr. Carbone earned a bachelor's degree in engineering from The United States Merchant Marine Academy in 1983. He served as a marine engineer for Military Sealift Command until 1988 and as a lieutenant in the United States Naval Reserve until 1993. He received his medical degree from the University of Maryland School of Medicine in 1992, and completed his orthopedic residency training and his reconstructive spinal surgery fellowship at The Johns Hopkins Hospital. Dr. Carbone has been a senior officer of two privately held orthopedic research and design companies, and is the inventor of several patented orthopedic devices and methods. We believe and have concluded that Dr. Carbone's significant knowledge of the medical device market and FDA regulatory processes and of business operations, which provides the Board with important insights into the Company's business strategies and opportunities, in addition to his extensive contacts in the medical field and with medical device and pharmaceutical corporations, make him a qualified and suitable director on our Board.

**Michael L. Krall** Mr. Krall is the Company's founder. Additionally, he has held the positions of President, CEO and Chairman of the Board since 1993, and is an inventor or co-inventor on the majority of our SDC patent portfolio. We believe and have concluded that Mr. Krall's unparalleled knowledge of our technology, our operations and our

relationships with our partners, which he has acquired through his more than nineteen years of full-time service to, and leadership of, the Company makes him a suitable candidate for re-election to the Board of Directors. In addition, the Board also believes and has concluded that Mr. Krall's leadership ability, dedication and commitment to excellence make him well suited to serve as a director and the Chairman of our Board.

Paul V. Maier Since November 2009, Mr. Maier has served as Chief Financial Officer of Sequenom, Inc., a life sciences company based in San Diego, California. Previously, he served as Vice President, Chief Financial Officer and became Senior Vice President, Chief Financial Officer of Ligand Pharmaceutical Inc., a biotechnology company, from 1992 to 2007. Prior to Ligand Pharmaceutical, Mr. Maier served as Vice President, Finance at DFS West, a division of DFS Group, L.P., a private multinational retailer from October 1990 to October 1992. From February 1990 to October 1990, Mr. Maier served as Vice President and Treasurer of ICN Pharmaceuticals, Inc., a pharmaceutical and biotechnology research products company. Mr. Maier held various positions in finance and administration at SPI Pharmaceuticals, Inc., a biotechnology company and a publicly held subsidiary of ICN Pharmaceuticals Group, from 1984 to 1988, including Vice President, Finance from February 1984 to February 1987. Mr. Maier earned an M.B.A. from Harvard Graduate School of Business and a B.S. from Pennsylvania State University. Mr. Maier also serves on the boards of directors of International Stem Cell Corp., Talon Therapeutics, Inc., and Apricus Biosciences, Inc., publicly-held biotechnology companies. We believe and have concluded that Mr. Maier's deep knowledge and understanding of financial operations and regulatory environments, through his service in senior management and board positions of U.S. public companies in the life sciences industry make him a qualified and suitable director on our Board. Additionally, we believe and have concluded that his service on other public company boards combined with his business acumen and judgment provide our Board with valuable accounting, financial and operational expertise and leadership.

Donna Singer Ms. Singer is the Executive Vice President of the Company and has been a director since 1998. From 1996 to 1998, Ms. Singer served as Vice President of Operations for the Company. Ms. Singer has extensive knowledge of our technology, our operations and our markets for our SDC technology, having been a senior executive at the Company for sixteen years. As a result of her experience and expertise, we believe and have concluded that Ms. Singer provides the Board with important insight into our operations, business strategies, communications, current and proposed strategic partners and the markets in which we compete, and that Ms. Singer’s expertise makes her a qualified and suitable director on our Board.

#### Information Regarding Executive Officers

Information with respect to our current named executive officers is shown below. Since each of the named executive officers also serve as a member of the Board, each such named executive officer’s biography is set forth under “Information Regarding the Board of Directors” above.

| Name             | Age | Position(s) Held                                | Position(s) Held Since |
|------------------|-----|---|------------------------|
| Michael L. Krall | 60  | President, CEO, Interim CFO, Chairman, Director | 1992 (1)               |
| Donna Singer     | 42  | Executive Vice President, Director              | 1998                   |

(1) Mr. Krall has served as the Interim CFO since the departure of Mr. Craig A. Johnson, our former Chief Financial Officer, who served in that position from August 2011 until his resignation in May 2012.

#### Family Relationships

There is no family relationship between any current director or executive officer, or any director or executive officer during the fiscal year ended July 31, 2012.

#### Audit Committee

The Board has established a separately-designated standing Audit Committee, which currently consists of two non-employee directors: Mr. Maier (chair) and Dr. Carbone. Prior to September 14, 2012, Mr. Barnhill was the third member of our Audit Committee. The Board has determined that each current member of the Audit Committee, and each member during the year ended July 31, 2012, is “independent” as defined by the applicable NASDAQ rules and regulations of the SEC, and that Mr. Maier qualifies as an “audit committee financial expert” as defined in such regulations. As stated above, we intend to appoint a third independent director who satisfies the requirements for membership on the Audit Committee as promptly as practicable.

#### Procedures for Stockholder Recommendations of Director Nominees

On October 12, 2012, our Board established a Nominating Committee and appointed two independent directors, Mr. Maier (chair) and Dr. Carbone, to serve as the members of such committee. Among other duties, the Nominating Committee is responsible for considering candidates for director nominees recommended by our stockholders, provided that stockholders submit written notice to us of any such nominee in compliance with the timing and other requirements set forth in our bylaws. Those timing or other requirements have not changed from the description thereof set forth in our definitive proxy statement on Schedule 14A, filed with the SEC on July 12, 2012 in connection with our 2012 annual meeting of stockholders.

#### Code of Business Conduct and Ethics

The Board has adopted a Code of Business Conduct and Ethics that applies to all of our officers, directors and employees. The Code of Business Conduct and Ethics is available on the corporate governance section of our website, [www.purebio.com](http://www.purebio.com). The Code of Business Conduct and Ethics contains general guidelines for conducting the business of our Company consistent with the highest standards of business ethics, and is intended to qualify as a “code of ethics” within the meaning of Section 406 of the Sarbanes-Oxley Act of 2002, and Item 406 of Regulation S-K promulgated

by the SEC.

**Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Exchange Act requires our directors and executive officers, and persons who own more than ten percent of our common stock, to file with the SEC initial reports of ownership and reports of changes in ownership of our common stock. We are not aware of any stockholders that own greater than ten percent of our outstanding common stock. Our officers and directors are required by SEC regulations to furnish us with copies of all Section 16(a) forms they file. To our knowledge, based solely on a review of the copies of such reports furnished to us and representations that no other reports were required during the year ended July 31, 2012, our officers and directors were in compliance with all applicable Section 16(a) filing requirements.

## Item 11. Executive Compensation

All information in this Item 11 regarding share amounts of our common stock and prices per share of our common stock has been adjusted to reflect the application of the one-for-eight reverse stock split of our common stock that we effected on August 14, 2012, as further described elsewhere in this Annual Report, on a retroactive basis.

## Summary Compensation Table

The following table sets forth a summary of cash and non-cash compensation awarded, earned or paid for services rendered to us during the years ended July 31, 2012 and July 31, 2011 by our named executive officers, consisting of (i) each individual serving as principal executive officer during the year ended July 31, 2012, and (ii) our two most highly compensated executive officers, other than the principal executive officer, who were serving as executive officers during the year ended July 31, 2012.

| Name and Principal Position   | Fiscal Year | Salary (\$)(1) | Bonus (\$)(2) | Stock Option Awards (\$)(3) | All Other Compensation (\$)(4) | Total Compensation (\$) |
|---|-------------|----------------|---------------|-----------------------------|--------------------------------|-------------------------|
| Michael L. Krall<br>President, Chief Executive Officer, Chief Financial Officer | 2012        | \$ 385,000     | -             | -                           | \$ 8,653                       | \$ 393,653              |
|   | 2011        | \$ 368,115     | \$ 97,500     | -                           | \$ 13,956 (5)                  | \$ 479,571              |
| Craig A. Johnson (6)<br>Chief Financial Officer                                 | 2012        | \$ 205,693     | -             | \$ 124,800                  | \$ 21,478 (7)                  | \$ 351,971              |
|   | 2011        | -              | -             | -                           | -                              | -                       |
| Donna Singer<br>Executive Vice President  | 2012        | \$ 220,000     | -             | -                           | \$ 4,860                       | \$ 224,860              |
|   | 2011        | \$ 214,615     | \$ 45,500     | -                           | \$ 4,320                       | \$ 264,435              |

(1) Amounts reflect salary actually paid during the respective fiscal years.

(2) Amounts reflect bonuses actually paid in the respective fiscal years.

(3) No stock option awards were granted to our named executive officers during the year ended July 31, 2011. Amounts for the year ended July 31, 2012 reflect the grant date fair value for financial statement reporting purposes with respect to stock options granted during the year ended July 31, 2012, calculated in accordance with authoritative guidance. All the assumptions for the stock options granted during the year ended July 31, 2012 are included in Note 9 to the audited consolidated financial statements set forth in Part II, Item 8 of this Annual Report

(4) Amount includes the cost of benefits paid by the Company on behalf of each named executive officer for health, dental, vision and life insurance.

(5) Amount includes a \$6,000 vehicle allowance for the year ended July 31, 2011. Subsequent to July 31, 2011, the vehicle allowance was terminated and no amounts were paid as part of this vehicle allowance during the year ended July 31, 2012.

(6) Mr. Johnson was appointed as our Chief Financial Officer effective as of August 1, 2011. Mr. Johnson resigned as our Chief Financial Officer in May 2012.

(7) Amount includes \$18,122 representing accrued vacation paid to Mr. Johnson upon his resignation in May 2012.

## Outstanding Equity Awards at Year-End

The following table provides a summary of equity awards outstanding at July 31, 2012, for each of our named executive officers. There were no outstanding unvested shares of restricted stock held by our named executive officers as of July 31, 2012.

| Name             | Option Awards   |   |                            |                        |
|------------------|---|---|----------------------------|------------------------|
|                  | Number of Securities Underlying Unexercised Options (#) Exercisable (1) | Number of Securities Underlying Unexercised Options (#) Unexercisable | Option Exercise Price (\$) | Option Expiration Date |
| Michael L. Krall | 6,250   | -   | \$ 45.60                   | 04/09/13               |
|                  | 18,750  | 6,250   | \$ 18.72                   | 05/14/14               |
|                  | 12,500  | 12,500  | \$ 24.72                   | 05/06/20               |
| Craig A. Johnson | 25,000  | -   | \$ 7.68                    | 08/01/21               |
| Donna Singer     | 6,250   | -   | \$ 45.60                   | 04/09/13               |
|                  | 7,500   | 2,500   | \$ 18.72                   | 05/14/14               |
|                  | 5,000   | 5,000   | \$ 24.72                   | 05/06/20               |

(1) All stock options for our named executive officers issued prior to the year ended July 31, 2009 were fully vested as of July 31, 2012. Except as noted below, all stock options for our named executive officers issued thereafter vest annually over four years. No stock option awards were granted to our named executive officers during the year ended July 31, 2011. During the year ended July 31, 2012, we granted 25,000 options to Mr. Johnson at the commencement of his employment with the Company, which vested immediately and had a ten-year term. The grant date fair value of awards granted in the year ended July 31, 2012 was \$124,800. The determination of the grant date fair value of the awards is further detailed in the notes to the audited consolidated financial statements set forth in Part II, Item 8 of this Annual Report.

## Employment Agreements; Potential Payments Upon Termination or a Change in Control

On October 12, 2009, the Company entered into an amended and restated employment agreement with Mr. Krall, which agreement amended and restated in its entirety the Company's former employment agreement with Mr. Krall entered into in April 1996. Also on October 12, 2009, the Company entered into an employment agreement with Donna Singer, our Executive Vice President. On October 26, 2011, the Company entered into amendments to each of the employment agreements with Mr. Krall and Ms. Singer. Those employment agreements and the amendments thereto are filed as exhibits to our Annual Report on Form 10-K for the fiscal years ended July 31, 2009 and July 31, 2011, respectively. On June 6, 2011, the Company entered into an employment agreement with Craig Johnson to serve as the Company's Chief Financial Officer commencing on August 1, 2011. Mr. Johnson's employment agreement is filed as an exhibit to our Annual Report on Form 10-K for the fiscal year ended July 31, 2011. Each employment agreement with our named executive officers and each amendment thereto was approved by the Board upon the recommendation of the Compensation Committee.

On May 4, 2012, Mr. Johnson resigned from his position as the Chief Financial Officer of the Company, and accordingly his employment agreement terminated on that date. Presently, Mr. Krall is acting as the Company's Interim Chief Financial Officer.

The terms of each employment agreement with our named executive officers provide that such agreement continues until termination by either the Company or the applicable executive officer. During the term of each employment agreement, the executive officers are entitled to an annual base salary, which may be increased, but not decreased, by the Board or the Compensation Committee in their discretion. The annual base salaries of our current named executive officers are \$385,000 for Mr. Krall and \$220,000 for Ms. Singer, and the annual base salary for Mr. Johnson upon his resignation was \$266,500.

Each agreement provides that, during the term of such agreement, the applicable executive officer is eligible for equity compensation grants to be awarded at the discretion of the Compensation Committee and the Board, and also provides for annual bonus targets equal to, as applicable, 50% of the executive's then current annual base salary for Mr. Krall and 35% of the executive's then current annual base salary for each of Ms. Singer and Mr. Johnson, in each case to be awarded at the sole discretion of the Compensation Committee and the Board. Additionally, pursuant to the terms of Mr. Johnson's employment agreement, upon the commencement of his employment, Mr. Johnson was granted an option to purchase 25,000 shares of the Company's common stock at the fair market value calculated on the date of such grant. That option has expired unexercised due to the termination of Mr. Johnson's employment by the Company. No additional options were granted to Mr. Johnson during the term of his employment.



In each case, the employment agreements with our named executive officers provide for certain compensation to be paid to the applicable named executive officer if his or her employment is terminated by the Company without Cause or terminated by the executive for Good Reason. In summary, "Cause" is the commission by the executive of an act of fraud or another felony, or gross misconduct resulting in a material adverse effect on the Company; refusal by the executive to perform his or her duties under the agreement or to otherwise breach the agreement, or the executive's breach of other key agreements with the Company. "Good Reason" is a material reduction of the executive's base salary or target bonus percentage; a material reduction by the Company of the executive's authority, duties or responsibilities; a relocation of the Company's offices that requires an increase in the executive's one-way driving distance of more than fifty miles; a material diminution in the authorities, duties or responsibilities of the supervisor to whom the executive is required to report (or, in the case of Mr. Krall, a requirement that Mr. Krall report to another person other than the Board); a material breach of the agreement by the Company; or a material diminution in the budget over which the executive retains authority.

Upon such event, the executive, upon signing a release in favor of the Company, would be entitled to severance pay in the form of a single lump sum cash payment. In the case of Mr. Krall, such severance payment would equal 150% of his then current annual base salary, plus eighteen months of health and dental insurance in accordance with COBRA for Mr. Krall and his eligible dependents. In the case of Ms. Singer, such severance payment would equal 100% of her then current annual base salary plus twelve months of health and dental insurance in accordance with COBRA for Ms. Singer and her eligible dependents. In the case of Mr. Johnson, such severance payment would equal 75% of Mr. Johnson's then current annual base salary plus nine months of health and dental insurance in accordance with COBRA for Mr. Johnson and eligible dependents. In addition, in the event of a termination for any reason other than by the Company for Cause, each agreement provides that all outstanding vested stock options held by the applicable executive at the date of such termination would continue to be exercisable for a period of up to 120 days following such termination, but in no event beyond the maximum permitted expiration date.

The employment agreements with our named executive officers also provide for compensation if the executive's employment is terminated by the Company without Cause within twelve months following a Change in Control, or the executive resigns for Good Reason within such period. A "Change in Control" is the closing of the sale, transfer or other disposition of all or substantially all of the Company's assets or the exclusive license of substantially all of the intellectual property of the Company; the consummation of a merger or consolidation of the Company with or into another entity; the closing of the acquisition of beneficial ownership of 30% or more of the outstanding voting stock of the Company; or if individuals who, on the effective date of the agreement are members of the Board, or are nominees of such Board members, cease to constitute at least a majority of the members of the Board.

Upon such event, the executive would be entitled to additional severance pay in excess of the amounts described above, in each case in an amount equal to a single lump sum payment equal to 100% of the applicable executive's then current annual base salary, plus the average annual bonus awarded to the executive for the preceding two fiscal years. In addition, in such event, the vesting of all outstanding stock options then held by the applicable executive would automatically accelerate and all stock options would continue to be exercisable for 12 months, but in no event beyond the maximum permitted expiration date.

The employment agreements, as amended, with each of our current named executive officers also provide that the Company may, in certain circumstances and in order to avoid incurring fines or penalties under applicable law (including recently enacted federal healthcare legislation), elect to pay cash payments equivalent to value of the monthly premiums the Company would otherwise pay to provide for the continuation of health and dental insurance for such executives and their eligible dependents following each such executive's termination without Cause or resignation for Good Reason.

If Mr. Krall had been terminated on July 31, 2012 without Cause or had terminated his employment for Good Reason, he would have received a lump sum payment of \$577,500 and the continued participation in our group health

insurance benefits on the same terms as during his employment until eighteen months following his termination, at a cost to us of \$7,750. Additionally, if Mr. Krall was terminated without Cause or resigned for Good Reason within twelve months following a Change in Control, he would have received the same benefits plus (i) an additional lump sum payment of \$385,000, (ii) a bonus payment of \$48,750, and (iii) the accelerated vesting of his unvested stock options with an aggregate intrinsic value of zero based on the closing price of our common stock on July 31, 2012.

If Ms. Singer had been terminated on July 31, 2012 without Cause or had terminated her employment for Good Reason, she would have received a lump sum payment of \$220,000 and the continued participation in our group health insurance benefits on the same terms as during her employment until twelve months following her termination, at a cost to us of \$6,994. Additionally, if Ms. Singer was terminated without Cause or resigned for Good Reason within twelve months following a Change in Control, she would have received the same benefits plus (i) an additional lump sum payment of \$220,000, (ii) a bonus payment of \$22,750, and (iii) the accelerated vesting of her unvested stock options with an aggregate intrinsic value of zero based on the closing price of our common stock on July 31, 2012.

Mr. Johnson's resignation in May 2012 did not constitute a termination by the Company without Cause, nor did it constitute a termination by Mr. Johnson for Good Reason. However, if Mr. Johnson had been terminated on that date without Cause or had terminated his employment for Good Reason, he would have received a lump sum payment of \$199,875 and the continued participation in our group health insurance benefits on the same terms as during his employment until nine months following his termination, at a cost to us of \$7,108. Additionally, if Mr. Johnson was terminated without Cause or resigned for Good Reason within twelve months following a Change in Control, he would have received the same benefits plus an additional lump sum payment of \$266,500 and (ii) the accelerated vesting of his unvested stock options (if any) with an aggregate intrinsic value of zero based on the closing price of our common stock on July 31, 2012.

#### Code Section 162(m) Provisions

Section 162(m) of the U.S. Internal Revenue Code, or the Code, generally disallows a tax deduction to public companies for compensation in excess of \$1 million paid to the Chief Executive Officer or any of the four most highly compensated officers. Performance-based compensation arrangements may qualify for an exemption from the deduction limit if they satisfy various requirements under Section 162(m). Although we consider the impact of this rule when developing and implementing our executive compensation programs, we believe it is important to preserve flexibility in designing compensation programs. Accordingly, we have not adopted a policy that all compensation must qualify as deductible under Section 162(m) of the Code. While our stock options are intended to qualify as "performance-based compensation" (as defined by the Code), amounts paid under our other compensation programs may not qualify as such.

#### Compensation of Directors

The following table shows amounts earned in the year ended July 31, 2012 by each of our directors who are not named executive officers.

| Name(1)             | Fees Earned<br>or Paid in<br>Cash (\$) | Stock Awards<br>(\$)(2)(3) | Option<br>Awards<br>(\$)(3) | All Other<br>Compensation<br>(\$) | Total<br>Compensation<br>(\$) |
|---------------------|--|----------------------------|-----------------------------|-----------------------------------|-------------------------------|
| Gregory H. Barnhill | \$ 43,000                              | \$ 5,211                   | -                           | -                                 | \$ 48,211                     |
| Dennis Brovarone    | \$ 35,000                              | \$ 5,211                   | -                           | \$ 60,000 (4)                     | \$ 100,211                    |
| John J. Carbone, MD | \$ 38,000                              | \$ 5,211                   | -                           | -                                 | \$ 43,211                     |
| Paul V. Maier       | \$ 60,000                              | \$ 5,211                   | -                           | -                                 | \$ 65,211                     |

- (1) Directors Michael L. Krall, our President, Chief Executive Officer and Interim Chief Financial Officer, and Donna Singer, our Executive Vice President, are not included on this table as they receive no compensation for their service as directors. The compensation received by Mr. Krall and Ms. Singer as executives is shown in the Summary Compensation Table in this Item 11 above.
- (2) Amounts reflect the grant date fair value for financial statement reporting purposes with respect to restricted stock grants issued during the year ended July 31, 2012. All assumptions for these calculations are included in Note 9 to the audited consolidated financial statements set forth in Part II, Item 8 of this Annual Report. During the year ended July 31, 2012, Mr. Barnhill, Mr. Brovarone, Dr. Carbone, and Mr. Maier elected to receive shares of our common stock, vesting one year from their grant, in lieu of options to purchase common stock.
- (3) The aggregate number of stock awards outstanding at July 31, 2012 for each independent director was as follows: Mr. Barnhill, 1,713; Mr. Brovarone, 1,713; Dr. Carbone, 1,713; and Mr. Maier, 1,713. The aggregate number of option awards outstanding at July 31, 2012 for each independent director was as follows: Mr. Barnhill, zero; Mr. Brovarone, 16,250; Dr. Carbone, 6,250; and Mr. Maier, 18,750.

(4) Amount represents fees earned for services to the Company as securities counsel in the year ended July 31, 2012.

In the past, our Board has approved each year, generally in the second calendar quarter of the year, an annual option or stock grant for our non-employee directors. Any such grant is at the discretion of the Board, which considers the recommendation of our Compensation Committee. Upon the Board's approval of any such grant, each non-employee director generally may elect whether to receive the grant as an option or stock award.

## Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table provides information regarding the beneficial ownership of our common stock as of October 24, 2012, or the Evaluation Date, by: (i) each of our current directors, (ii) each of our named executive officers as set forth in Item 11 of this Annual Report, and (iii) all such directors and executive officers as a group. We know of no other person or group of affiliated persons who beneficially own more than five percent of our common stock. The table is based upon information supplied by our officers, directors and principal stockholders and a review of Schedules 13D and 13G, if any, filed with the SEC. Unless otherwise indicated in the footnotes to the table and subject to community property laws where applicable, we believe that each of the stockholders named in the table has sole voting and investment power with respect to the shares indicated as beneficially owned. All information in the following table regarding share amounts of our common stock has been adjusted to reflect the application of the one-for-eight reverse stock split of our common stock that we effected on August 14, 2012, as further described elsewhere in this Annual Report, on a retroactive basis.

Applicable percentages are based on 10,986,170 shares outstanding as of the Evaluation Date, adjusted as required by rules promulgated by the SEC. These rules generally attribute beneficial ownership of securities to persons who possess sole or shared voting power or investment power with respect to those securities. In addition, the rules include shares of our common stock issuable pursuant to the exercise of stock options or warrants that are either immediately exercisable or exercisable within 60 days of the Evaluation Date. These shares are deemed to be outstanding and beneficially owned by the person holding those options for the purpose of computing the percentage ownership of that person, but they are not treated as outstanding for the purpose of computing the percentage ownership of any other person.

| Name (1)(2)   | Number of<br>Shares<br>Beneficially<br>Owned |     | Percent of<br>Common<br>Stock |   |
|---|--|-----|-------------------------------|---|
| Dennis Brovarone  | 49,856                                       | (3) | *                             |   |
| John J. Carbone, MD   | 20,182                                       | (4) | *                             |   |
| Michael L. Krall  | 197,724                                      | (5) | 1.79                          | % |
| Paul V. Maier   | 27,388                                       | (6) | *                             |   |
| Donna Singer  | 65,344                                       | (7) | *                             |   |
| All of our named executive officers and directors<br>as a group (5 persons) | 360,494                                      | (8) | 3.25                          | % |

\* Indicates less than one percent of the outstanding shares of the Company's common stock.

- (1) The address for each person listed in the table is c/o Pure Bioscience, Inc., 1725 Gillespie Way, El Cajon, California 92020.
- (2) As of September 14, 2012, Gregory H. Barnhill, a former director on our Board, directly held 89,787 shares of common stock. Subsequent to Mr. Barnhill's death, such shares are held by Mr. Barnhill's estate
- (3) Consists of (a) 16,250 shares of common stock subject to options currently exercisable or exercisable within 60 days of the Evaluation Date, and (b) 33,606 shares of common stock held directly by Mr. Brovarone.
- (4) Consists of (a) 6,250 shares of common stock subject to options currently exercisable or exercisable within 60 days of the Evaluation Date, and (b) 13,932 shares of common stock held directly by Dr. Carbone.
- (5) Consists of (a) 37,500 shares of common stock subject to options currently exercisable or exercisable within 60 days of the Evaluation Date, and (b) 160,224 shares of common stock held directly by Mr. Krall.
- (6) Consists of (a) 18,750 shares of common stock subject to options currently exercisable or exercisable within 60 days of the Evaluation Date, and (b) 8,638 shares of common stock held directly by Mr. Maier.
- (7)

Consists of (a) 18,750 shares of common stock subject to options currently exercisable or exercisable within 60 days of the Evaluation Date, and (b) 46,594 shares of common stock held directly by Ms. Singer.

- (8) Consists of (a) 97,500 shares of common stock subject to options currently exercisable or exercisable within 60 days of the Evaluation Date, and (b) 352,781 shares of common stock held directly by all directors and executive officers as a group.

#### Equity Compensation Plan Information

The 2007 PURE Bioscience Equity Incentive Plan, or the Plan, is our only active equity incentive plan pursuant to which options to acquire common stock or restricted stock awards have been granted and are currently outstanding. Approved by our stockholders in April 2007, the Plan has a share reserve of 625,000 shares of common stock. The Plan provides for the grant of incentive and non-qualified stock options, as well as stock appreciation rights, common stock awards, restricted stock units, performance units and shares, and other stock-based awards. Eligible participants include employees, directors, officers and advisors, although incentive stock options generally may be granted only to employees.

All of our equity incentive plans are administered by the Compensation Committee. The exercise price for stock options is always at or above the fair market value of our common stock on the date the award is granted. Fair market value is defined by the Plan and is based on prevailing market prices of our common stock as reported by the NASDAQ Capital Market. The term of stock options granted and their vesting schedules are determined by the Compensation Committee, subject to any limitations defined in the Plan. The Compensation Committee also determines the vesting of other, non-option, stock awards.

The following table sets forth, as of July 31, 2012, information with respect to our equity compensation plans, and with respect to certain other options and warrants.

| Plan Category  | Number of securities to be issued upon exercise of outstanding options, warrants and rights<br>(a)(1) | Weighted average exercise price of outstanding options, warrants and rights<br>(b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))<br>(c) |
|--|---|--|--|
| Equity compensation plans approved by stockholders     | 348,463   | \$ 19.26   | 222,351  |
| Equity compensation plans not approved by stockholders | -   | -  | -  |
| Total  | 348,463   | \$ 19.26   | 222,351  |

(1) Includes options only.

### Item 13. Certain Relationships and Related Transactions, and Director Independence

#### Certain Relationships and Related Transactions

Except as described below and other than employment relationships and compensation resulting from those employment relationships, no director, executive officer, or immediate family member of any of the foregoing, was a party to any transaction or series of transactions since the beginning of the year ended July 31, 2011, or is to be a party to any currently proposed transaction or series of proposed transactions, in which (i) we were or are to be a participant, (ii) the amount involved exceeds the lesser of \$120,000 or one percent of the average of our total assets at fiscal year-end for the fiscal years ended July 31, 2012 and 2011, which is \$48,030, and (iii) any director, executive officer, or immediate family member of any of the foregoing had or will have a direct or indirect material interest.

Our current Director of Manufacturing and Research and Development, Richard Gumienny, is the son-in-law of Michael Krall, our President, Chief Executive Officer, Interim Chief Financial Officer, and Chairman of the Board. Pursuant to the terms of Mr. Gumienny's employment arrangement with us, which has been in effect during the period commencing at the beginning of our fiscal year ended July 31, 2011 and continuing through the date of this Annual Report, Mr. Gumienny (1) receives an annual salary of \$110,000, (2) receives certain benefits that are also provided to our other similarly situated employees, which benefits have an approximate annual value of \$4,861 for Mr. Gumienny, and (3) is eligible to receive cash bonuses and equity grants at the discretion of management. In accordance with that arrangement, during the fiscal year ended July 31, 2011, Mr. Gumienny was awarded a cash bonus of \$2,626 and options to purchase up to 9,375 shares of our common stock in addition to his salary and benefits.

Our current Accounts Receivable and Accounts Payable Manager, Ashley Gumienny, is the daughter of Michael Krall, our President, Chief Executive Officer, Interim Chief Financial Officer, and Chairman of the Board. Pursuant to the terms of Ms. Gumienny's employment arrangement with us, which has been in effect during the period commencing at the beginning of our fiscal year ended July 31, 2011 and continuing through the date of this Annual

Report, Ms. Gumienny (1) receives an annual salary of \$52,500, (2) receives certain benefits that are also provided to our other similarly situated employees, which benefits have an approximate annual value of \$4,861 for Ms. Gumienny, and (3) is eligible to receive cash bonuses and equity grants at the discretion of management. In accordance with that arrangement, during the fiscal year ended July 31, 2011, Ms. Gumienny was awarded a cash bonus of \$1,785 in addition to her salary and benefits.

One of our current directors, Dennis Brovarone, provides consulting services for us as securities counsel in addition to his services as a director. Pursuant to the terms of Mr. Brovarone's consulting arrangement with us, which has been in effect during the period commencing at the beginning of our fiscal year ended July 31, 2011 and continuing through the date of this Annual Report, Mr. Brovarone receives annual cash compensation of \$60,000 in exchange for his services as a consultant. Such amounts are in addition to the cash, equity or other compensation Mr. Brovarone receives in exchange for his services as a director. Please see the table under the heading "Compensation of Directors" in Item 11 of this Annual Report for further information about Mr. Brovarone's director compensation.

For information with respect to other transactions and relationships between the Company and certain executive officers, directors and related persons, see the description of the employment agreements with our named executive officers under the heading "Employment Agreements; Potential Payments Upon Termination or a Change in Control" in Item 11 of this Annual Report.



Pursuant to the charter of our Audit Committee, all transactions between us and any of our directors, executive officers or other related parties are subject to review by our Audit Committee.

#### Director Independence

The Board annually determines the independence of each director, based on the independence criteria set forth in NASDAQ's applicable listing rules. In making its determinations, the Board considers all relevant facts and circumstances brought to its attention as well as information provided by the directors and a review of any relevant transactions or relationships between each director or any member of his or her family, and the Company, its senior management or the Company's independent registered public accounting firm. Based on its review, the Board has unanimously determined that Dennis Brovarone, John Carbone and Paul Maier are each independent under applicable NASDAQ criteria, and that each member of the standing committees of the Board is independent under NASDAQ independence standards applicable to each such committee. Additionally, the Board has determined that Mr. Krall and Ms. Singer are not independent because they currently are executive officers of the Company.

Due to the death of Gregory Barnhill on September 14, 2012, our Audit Committee is not currently comprised of three independent directors as required by applicable NASDAQ listing rules. We have notified NASDAQ of such non-compliance, and intend to appoint one or more independent directors to our Board and the Audit Committee thereof who satisfy all applicable qualifications and other requirements therefor as promptly as practicable

#### Item 14. Principal Accounting Fees and Services

##### Independent Registered Public Accounting Firm's Fee Summary

The following table provides information regarding the fees billed to us by Mayer Hoffman McCann P.C. in the years ended July 31, 2012 and 2011. All fees described below were approved by the Board or the Audit Committee:

|                        | For the years ended July 31, |           |     |
|------------------------|------------------------------|-----------|-----|
|                        | 2012                         | 2011      |     |
| Audit Fees (1)         | \$156,000                    | \$132,000 | (2) |
| Audit-Related Fees (3) | 26,000                       | 38,000    |     |
| Tax Fees (4)           | 10,000                       | 9,000     |     |
| All Other Fees (5)     | -                            | 1,000     |     |
| Total Fees             | \$192,000                    | \$180,000 |     |

- (1) Audit Fees include fees for services rendered for the audit and/or review of our financial statements, including our Annual Report on Form 10-K and our periodic reports.
- (2) Includes fees billed in the year ended July 31, 2011 for services rendered for the review of our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002 for the year ended July 31, 2010.
- (3) Audit Related Fees consist of amounts billed for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements. Amounts for the year ended July 31, 2012 included fees incurred related primarily to the filing of registration statements related to the financings further detailed in the notes to the audited consolidated financial statements set forth in Part II, Item 8 of this Annual Report. Amounts for the year ended July 31, 2011 included fees incurred related primarily to the at the market financing further detailed in the notes to the audited consolidated financial statements set forth in Part II, Item 8 of this Annual Report.
- (4) Tax Fees consist of amounts billed for services in connection with the preparation of our federal and state tax returns.

- (5) All Other Fees consist of amounts billed for other permissible work by Mayer Hoffman McCann P.C. that is not included in the above category descriptions. No such amounts were incurred in the year ended July 31, 2012. Amounts for the year ended July 31, 2011 included fees incurred related to the Securities and Exchange Commission comment letters received in May 2011.

#### Pre-Approval Policies and Procedures

Our Audit Committee's policy is to pre-approve all audit and permissible non-audit services provided by our independent auditors. These services may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of services. The independent auditor and management are required to periodically report to the Audit Committee regarding the extent of services provided by the independent auditor in accordance with this pre-approval. Any proposed services not included within the list of pre-approved services or any proposed services that will cause the Company to exceed the pre-approved aggregate amount requires specific pre-approval by the Audit Committee. All audit fees, audit-related fees, tax fees, and other fees listed in the table above were approved by the Audit Committee pursuant to its pre-approval policies and procedures.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) The list of financial statements filed in response to Part II, Item 8 is set forth at the end of this Annual Report.

(2) Schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

(3) The following exhibits are filed as part of this Annual Report pursuant to Item 601 of Regulation S-K:

- |       |       |   |
|-------|-------|---|
| 2.1   | (1)   | Agreement and Plan of Merger, dated as of March 24, 2011, by and between Pure Bioscience and Pure Bioscience, Inc.    |
| 3.1   | *     | Certificate of Incorporation of Pure Bioscience, Inc.   |
| 3.1.1 | *     | Certificate of Amendment to Certificate of Incorporation of Pure Bioscience, Inc.                                     |
| 3.2   | *     | Bylaws of Pure Bioscience, Inc.   |
| 3.2.1 | *     | Amendment to the Bylaws of Pure Bioscience, Inc.  |
| 4.1   | (2)   | Form of Investor Warrant  |
| 4.2   | (3)   | Form of Investor Warrant  |
| 10.1  | (4)   | PURE Bioscience 2007 Equity Incentive Plan  |
| 10.2  | (5)#  | Amended and Restated Employment Agreement by and between Pure Bioscience and Michael L. Krall, dated October 12, 2009 |
| 10.3  | (6)#  | Employment Agreement by and between Pure Bioscience and Donna Singer, dated October 12, 2009                          |
| 10.4  | (7)   | Sales Agreement, dated as of April 29, 2011, by and between Pure Bioscience, Inc. and C.K. Cooper & Company, Inc.     |
| 10.5  | (8)#  | Employment Agreement by and between Pure Bioscience, Inc. and Craig Johnson, dated October 26, 2011                   |
| 10.6  | (9)#  | Form of Indemnification Agreement   |
| 10.7  | (10)# | Amendment to Amended and Restated Employment Agreement by and between   |

Pure Bioscience, Inc. and Michael L.  
Krall, dated October 26, 2011

- 10.8 (11)#      Amendment to Employment Agreement  
by and between Pure Bioscience, Inc.  
and Donna Singer, dated October 26,  
2011
- 10.9 (12)      Purchase Agreement, dated December  
14, 2011, by and between Pure  
Bioscience, Inc. and Lincoln Park Capital  
Fund, LLC
- 10.10(13)      Purchase Agreement, dated December  
15, 2011, by and between Pure  
Bioscience, Inc. and Lincoln Park Capital  
Fund, LLC
- 10.11(14)      Registration Rights Agreement, dated  
December 15, 2011, by and between  
Pure Bioscience, Inc. and Lincoln Park  
Capital Fund, LLC
- 10.12(15)      Engagement Letter, dated December 8,  
2011, by and between Pure Bioscience,  
Inc. and Wharton Capital Markets LLC
- 10.13(16)      Warrant, dated February 3, 2012, issued  
by Pure Bioscience, Inc. to Wharton  
Capital Markets LLC
- 10.14(17)      First Amendment to Purchase  
Agreement, dated April 5, 2012, by and  
between Pure Bioscience, Inc. and  
Lincoln Park Capital Fund, LLC

- 10.15(18) Securities Purchase Agreement, dated June 26, 2012, by and between Pure Bioscience, Inc. and each purchaser identified on the signature pages thereto
- 10.16(19) Form of Secured Convertible Promissory Note
- 10.17(20) Security Agreement, dated June 26, 2012, by and between Pure Bioscience, Inc. and the holder of the Notes identified on the signature pages thereto
- 10.18(21) Stock Escrow Agreement, dated June 26, 2012, by and among Pure Bioscience, Inc., the holder of the Notes identified on Schedule I thereto and U.S. Bank National Association
- 10.19(22) Form of Common Stock Purchase Warrant
- 10.20(23) Securities Purchase Agreement, dated June 29, 2012, among Pure Bioscience, Inc. and each purchaser identified on the signature pages thereto
- 10.21(24) Form of Common Stock Purchase Warrant
- 10.22(25) Addendum to Transaction Documents, dated July 5, 2012, by and among Pure Bioscience, Inc. and each purchaser identified on the signature pages thereto
- 10.23(26) Settlement Agreement, effective July 9, 2012, among Pure Bioscience, Inc. Richmond Sciences, LLC, Richmond Holdings, Inc., Richmond Corporation, IV-7 Direct, LLC, and The Coalition to Save Pure
- 10.24(27) Second Addendum to Transaction Documents, dated August 20, 2012, by and between Pure Bioscience, Inc. and each purchaser identified on the signature pages thereto
- 10.25(28) Third Addendum to Transaction Documents, dated August 20, 2012, by

and between Pure Bioscience, Inc. and each purchaser identified on the signature pages thereto

- 10.26(29) Underwriting Agreement, dated September 11, 2012, by and between Pure Bioscience, Inc. and Aegis Capital Corp.
- 10.27(30) Form of Underwriter Warrant
- 14.1 (31) Code of Business Conduct and Ethics
- 21.1 (32) Subsidiaries of the Registrant
- 23.1 \* Consent of Mayer Hoffman McCann P.C.
- 31.1 \* Certification of Chief Executive Officer / Interim Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 \* Certification of Chief Executive Officer / Interim Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101 \*+ The following materials from the Company's Annual Report on Form 10-K for the annual period ended July 31, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as at July 31, 2012 and 2011; (ii) Consolidated Statements of Operations for the years ended July 31, 2012 and 2011; (iii) Consolidated Statements of Stockholders' Equity for the years ended July 31, 2012 and 2011, (iv) Consolidated Statements of Cash Flows for the years ended July 31, 2012 and 2011; and (iv) Notes to Consolidated Financial Statements.

- \* Filed herewith
- # Management contract or compensatory plan or arrangement.
- + Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act, are deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise are not subject to liability under those sections.
- (1) Incorporated by reference to Exhibit 2.1 to the Current Report on Form 8-K, filed with the SEC on March 25, 2011
- (2) Incorporated by reference to Exhibit 4.5 to the Current Report on Form 8-K, filed with the SEC on May 22, 2009
- (3) Incorporated by reference to Exhibit 4.5 to the Current Report on Form 8-K, filed with the SEC on September 2, 2009
- (4) Incorporated by reference from Exhibit 10.15.8 to the Annual Report on Form 10-K, filed with the SEC on October 14, 2008
- (5) Incorporated by reference to Exhibit 10.18 to the Annual Report on Form 10-K, filed with the SEC on October 13, 2009
- (6) Incorporated by reference to Exhibit 10.20 to the Annual Report on Form 10-K, filed with the SEC on October 13, 2009
- (7) Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K, filed with the SEC on April 29, 2011.
- (8) Incorporated by reference to Exhibit 10.8 to the Annual Report on Form 10-K, filed with the SEC on October 31, 2011
- (9) Incorporated by reference to Exhibit 10.9 to the Annual Report on Form 10-K, filed with the SEC on October 31, 2011
- (10) Incorporated by reference to Exhibit 10.10 to the Annual Report on Form 10-K, filed with the SEC on October 31, 2011
- (11) Incorporated by reference to Exhibit 10.11 to the Annual Report on Form 10-K, filed with the SEC on October 31, 2011
- (12) Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the SEC on December 15, 2011
- (13) Incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the SEC on December 15, 2011
- (14)

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Incorporated by reference to Exhibit 10.3 of the Current Report on Form 8-K filed with the SEC on December 15, 2011

- (15) Incorporated by reference to Exhibit 10.4 of the Current Report on Form 8-K filed with the SEC on December 15, 2011
- (16) Incorporated by reference to Exhibit 4.1 of the Quarterly Report on Form 10-Q filed with the SEC on March 16, 2012
- (17) Incorporated by reference to Exhibit 10.15 of the Registration Statement on Form S-1 filed with the SEC on April 10, 2012
- (18) Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the SEC on June 29, 2012
- (19) Incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the SEC on June 29, 2012
- (20) Incorporated by reference to Exhibit 10.3 of the Current Report on Form 8-K filed with the SEC on June 29, 2012
- (21) Incorporated by reference to Exhibit 10.4 of the Current Report on Form 8-K filed with the SEC on June 29, 2012
- (22) Incorporated by reference to Exhibit 10.5 of the Current Report on Form 8-K filed with the SEC on June 29, 2012
- (23) Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the SEC on July 6, 2012
- (24) Incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the SEC on July 6, 2012
- (25) Incorporated by reference to Exhibit 10.6 of the Current Report on Form 8-K/A filed with the SEC on July 13, 2012
- (26) Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the SEC on July 12, 2012



- (27) Incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the SEC on September 14, 2012
- (28) Incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the SEC on September 14, 2012
- (29) Incorporated by reference to Exhibit 1.1 of the Current Report on Form 8-K filed with the SEC on September 13, 2012
- (30) Incorporated by reference to Exhibit 4.1 of the Current Report on Form 8-K filed with the SEC on September 13, 2012
- (31) Incorporated by reference to Exhibit 14.1 to the Current Report on Form 8-K, filed with the SEC on February 25, 2008
- (32) Incorporated by reference to Exhibit 21.1 to the Annual Report on Form 10-K, filed with the SEC on October 13, 2009

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

|   |                  |
|---|------------------|
| PURE BIOSCIENCE, INC.   | DATE             |
| <br>/s/ MICHAEL L. KRALL<br>Michael L. Krall<br>President/Chief Executive Officer, Interim Chief Financial Officer<br>(Principal Executive, Financial and Accounting Officer) | October 29, 2012 |

Pursuant to the requirements of the Securities Exchange Act of 1934, this report is signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| NAME                                     | TITLE   | DATE             |
|--|---|------------------|
| /s/ DENNIS BROVARONE<br>Dennis Brovarone | Director  | October 29, 2012 |
| /s/ JOHN J. CARBONE<br>John J. Carbone   | Director  | October 29, 2012 |
| /s/ MICHAEL L. KRALL<br>Michael L. Krall | President/CEO, Interim CFO, Chairman,<br>Director | October 29, 2012 |
| /s/ PAUL V. MAIER<br>Paul V. Maier       | Director  | October 29, 2012 |
| /s/ DONNA SINGER<br>Donna Singer         | Executive Vice President and Director             | October 29, 2012 |

Index to Consolidated Financial Statements

|  |     |
|--|-----|
| Report of Independent Registered Public Accounting Firm                                    | F-2 |
| Consolidated Balance Sheets as of July 31, 2012 and 2011                                   | F-3 |
| Consolidated Statements of Operations for the years ended July 31, 2012 and 2011           | F-4 |
| Consolidated Statements of Stockholders' Equity for the years ended July 31, 2012 and 2011 | F-5 |
| Consolidated Statements of Cash Flows for the years ended July 31, 2012 and 2011           | F-6 |
| Notes to Consolidated Financial Statements   | F-7 |

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
Pure Bioscience, Inc.

We have audited the accompanying consolidated balance sheets of Pure Bioscience, Inc. as of July 31, 2012 and 2011, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Pure Bioscience, Inc. as of July 31, 2012 and 2011, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Mayer Hoffman McCann P.C.  
San Diego, California  
October 29, 2012

Pure Bioscience, Inc.  
Consolidated Balance Sheets

|  | July 31,<br>2012 | July 31,<br>2011 |
|--|------------------|------------------|
| Assets   |                  |                  |
| Current assets   |                  |                  |
| Cash and cash equivalents  | \$ 877,000       | \$ 1,794,000     |
| Accounts receivable, net   | 373,000          | 50,000           |
| Inventories, net   | 654,000          | 861,000          |
| Prepaid expenses   | 347,000          | 100,000          |
| Total current assets   | 2,251,000        | 2,805,000        |
| Property, plant and equipment, net   | 257,000          | 426,000          |
| Patents, net   | 1,950,000        | 1,917,000        |
| Total assets   | \$ 4,458,000     | \$ 5,148,000     |
| Liabilities and stockholders' equity   |                  |                  |
| Current liabilities  |                  |                  |
| Accounts payable   | \$ 1,946,000     | \$ 677,000       |
| Loan payable, net  | 962,000          | -                |
| Accrued liabilities  | 344,000          | 258,000          |
| Derivative liability   | 319,000          | -                |
| Deferred revenue   | 66,000           | -                |
| Total current liabilities  | 3,637,000        | 935,000          |
| Deferred rent  | 3,000            | 6,000            |
| Total liabilities  | 3,640,000        | 941,000          |
| Commitments and contingencies (Note 7)   |                  |                  |
| Stockholders' equity   |                  |                  |
| Preferred stock, \$0.01 par value:   |                  |                  |
| 5,000,000 shares authorized, no shares issued  | -                | -                |
| Common stock, \$0.01 par value:  |                  |                  |
| 100,000,000 shares authorized  |                  |                  |
| 6,644,555 issued and outstanding at July 31, 2012, and<br>5,004,275 issued and outstanding at July 31, 2011. | 67,000           | 50,000           |
| Additional paid-in capital   | 63,251,000       | 57,767,000       |
| Accumulated deficit  | (62,500,000 )    | (53,610,000 )    |
| Total stockholders' equity   | 818,000          | 4,207,000        |
| Total liabilities and stockholders' equity   | \$ 4,458,000     | \$ 5,148,000     |

See accompanying notes.

Pure Bioscience, Inc.  
Consolidated Statements of Operations

|  | Year ended<br>July 31, |                |
|--|------------------------|----------------|
|  | 2012                   | 2011           |
| Revenue  |                        |                |
| Net product sales  | \$812,000              | \$454,000      |
| License fees   | -                      | 10,000         |
| Total revenue  | 812,000                | 464,000        |
| Operating costs and expenses                                     |                        |                |
| Cost of goods sold   | 264,000                | 131,000        |
| Selling, general and administrative                              | 7,439,000              | 6,520,000      |
| Research and development   | 1,863,000              | 2,180,000      |
| Total operating costs and expenses                               | 9,566,000              | 8,831,000      |
| Loss from operations   | (8,754,000 )           | (8,367,000 )   |
| Other income (expense)   |                        |                |
| Change in derivative liability                                   | 11,000                 | -              |
| Interest expense   | (145,000 )             | -              |
| Interest income  | 1,000                  | 8,000          |
| Other (expense) income, net                                      | (3,000 )               | 10,000         |
| Total other (expense) income                                     | (136,000 )             | 18,000         |
| Net loss   | \$(8,890,000 )         | \$(8,349,000 ) |
| Basic and diluted net loss per share                             | \$(1.58 )              | \$(1.79 )      |
| Shares used in computing basic<br>and diluted net loss per share | 5,623,453              | 4,665,371      |

See accompanying notes.

Pure Bioscience, Inc.  
Consolidated Statements of Stockholders' Equity

|   | Common Stock |           | Additional         | Accumulated     | Total                   |
|---|--------------|-----------|--------------------|-----------------|-------------------------|
|   | Shares       | Amount    | Paid-In<br>Capital | Deficit         | Stockholders'<br>Equity |
| Balance, July 31, 2010                                  | 4,435,984    | \$ 45,000 | \$ 50,609,000      | \$ (45,261,000) | \$ 5,393,000            |
| Issuance of common stock in a private placement, net    | 135,000      | 1,000     | 2,366,000          | -               | 2,367,000               |
| Issuance of common stock in a registered offering, net  | 329,571      | 3,000     | 3,062,000          | -               | 3,065,000               |
| Share-based compensation expense - stock options        | -            | -         | 1,010,000          | -               | 1,010,000               |
| Share-based compensation expense - restricted stock     | 12,637       | -         | 184,000            | -               | 184,000                 |
| Issuance of common stock upon exercise of stock options | 75,663       | 1,000     | 277,000            | -               | 278,000                 |
| Issuance of common stock upon exercise of warrants      | 15,420       | -         | 259,000            | -               | 259,000                 |
| Net loss  | -            | -         | -                  | (8,349,000 )    | (8,349,000)             |
| Balance, July 31, 2011                                  | 5,004,275    | \$ 50,000 | \$ 57,767,000      | \$ (53,610,000) | \$ 4,207,000            |
| Issuance of common stock in a registered offering, net  | 167,136      | 2,000     | 947,000            | -               | 949,000                 |
| Issuance of common stock under purchase plan            | 718,463      | 7,000     | 1,712,000          | -               | 1,719,000               |
| Issuance of common stock in a private placement, net    | 575,125      | 6,000     | 1,144,000          | -               | 1,150,000               |
| Issuance of common stock under bridge loan              | 55,503       | 1,000     | 167,000            | -               | 168,000                 |
| Share-based compensation expense - stock options        | -            | -         | 1,036,000          | -               | 1,036,000               |
| Share-based compensation expense - restricted stock     | 6,852        | -         | 41,000             | -               | 41,000                  |
| Commitment shares issued under purchase plan            | 78,451       | 1,000     | 295,000            | -               | 296,000                 |
| Issuance of common stock for consulting agreements      | 38,750       | -         | 142,000            | -               | 142,000                 |
| Net loss  | -            | -         | -                  | (8,890,000 )    | (8,890,000)             |
| Balance, July 31, 2012                                  | 6,644,555    | \$ 67,000 | \$ 63,251,000      | \$ (62,500,000) | \$ 818,000              |

See accompanying notes.

F-5

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Pure Bioscience, Inc.  
Consolidated Statements of Cash Flows

|   | Year ended<br>July 31, |                |
|---|------------------------|----------------|
|   | 2012                   | 2011           |
| <b>Operating activities</b>   |                        |                |
| Net loss  | \$(8,890,000 )         | \$(8,349,000 ) |
| Adjustments to reconcile net loss to net cash used in operating activities:   |                        |                |
| Share-based compensation  | 1,077,000              | 1,194,000      |
| Amortization of stock issued for services                                     | 118,000                | -              |
| Depreciation and amortization   | 385,000                | 471,000        |
| Amortization of stock issued under purchase agreement                         | 296,000                | -              |
| Amortization of deferred financing costs                                      | 53,000                 | -              |
| Change in fair value of derivative liability                                  | (11,000 )              | -              |
| Amortization of debt discount   | 91,000                 | -              |
| Changes in operating assets and liabilities:                                  |                        |                |
| Accounts receivable   | (323,000 )             | 282,000        |
| Inventories   | 207,000                | (108,000 )     |
| Prepaid expenses  | (9,000 )               | 46,000         |
| Accounts payable and accrued liabilities                                      | 1,355,000              | 361,000        |
| Deferred revenue  | 66,000                 | (10,000 )      |
| Deferred rent   | (3,000 )               | (11,000 )      |
| Net cash used in operating activities   | (5,588,000 )           | (6,124,000 )   |
| <b>Investing activities</b>   |                        |                |
| Investment in patents   | (239,000 )             | (230,000 )     |
| Purchases of property, plant and equipment                                    | (10,000 )              | (14,000 )      |
| Net cash used in investing activities   | (249,000 )             | (244,000 )     |
| <b>Financing activities</b>   |                        |                |
| Net proceeds from the sale of common stock                                    | 3,818,000              | 5,432,000      |
| Net proceeds from Bridge Loan   | 1,200,000              | -              |
| Deferred financing costs  | (98,000 )              | -              |
| Net proceeds from exercise of stock options and warrants                      | -                      | 537,000        |
| Net cash provided by financing activities                                     | 4,920,000              | 5,969,000      |
| Net decrease in cash and cash equivalents                                     | (917,000 )             | (399,000 )     |
| Cash and cash equivalents at beginning of year                                | 1,794,000              | 2,193,000      |
| Cash and cash equivalents at end of year                                      | \$877,000              | \$1,794,000    |
| <b>Supplemental disclosure of cash flow information</b>                       |                        |                |
| Cash paid for taxes   | \$5,000                | \$2,000        |
| <b>Supplemental disclosure of non-cash investing and financing activities</b> |                        |                |
| Common stock issued for prepaid services                                      | \$142,000              | \$-            |

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|  |           |     |
|--|-----------|-----|
| Common stock issued under stock purchase agreement | \$296,000 | \$- |
| Common stock issued under Bridge Loan              | \$168,000 | \$- |
| Fair value of derivative liabilities               | \$330,000 | \$- |

See accompanying notes.

F-6

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Pure Bioscience, Inc.  
Notes to Consolidated Financial Statements

1. Organization and Business

All references to “PURE,” “we”, “our,” and “us” refer to Pure Bioscience, Inc. and our wholly owned subsidiary.

Pure Bioscience, Inc. is focused on the discovery, development and commercialization of bioscience products that provide solutions to global health challenges. Our technology platform is based on stabilized ionic silver, and our initial products contain silver dihydrogen citrate, or SDC. SDC is a broad-spectrum, non-toxic antimicrobial. Our goal is to become a sustainable company by using our proprietary technology platform to deliver leading antimicrobial products to multiple industries.

We were incorporated in the state of California in August 1992 as Innovative Medical Services. In September 2003, we changed our name to Pure Bioscience. In March 2011, we reincorporated in the state of Delaware. We operate in one business segment.

Effective on August 14, 2012 and commencing with the opening of trading on August 15, 2012, we effected a reverse stock split of our issued and outstanding common stock, \$0.01 par value per share, at a ratio of one-for-eight, with each eight (8) issued and outstanding shares of our common stock automatically combined and converted into one (1) issued and outstanding share of our common stock. The reverse stock split was approved by stockholders holding a majority of our outstanding voting power at our annual meeting of stockholders held on July 31, 2012. All information in our consolidated financial statements and the notes thereto regarding share amounts of our common stock and prices per share of our common stock has been adjusted to reflect the application of the reverse stock split on a retroactive basis, unless otherwise noted.

Since our inception, we have financed our operations primarily through public and private offerings of securities, revenue from product sales and license agreements, proceeds from the sale of a division and interest income from invested cash balances. We have a history of recurring losses, and we have incurred a cumulative net loss of \$62,500,000.

Our future capital requirements depend on numerous forward-looking factors. These factors may include, but are not limited to, the following: the acceptance of, and demand for, our products; our success and the success of our partners in selling our products; our success and the success of our partners in obtaining regulatory approvals to sell our products; the costs of further developing our existing products and technologies; the extent to which we invest in new product and technology development; and the costs associated with the continued operation, and any future growth, of our business. The outcome of these and other forward-looking factors will substantially affect our liquidity and capital resources.

We expect that we will need to increase our liquidity and capital resources by one or more measures. These measures may include, but are not limited to, the following: reducing operating expenses; obtaining financing through the issuance of equity, debt, or convertible securities; entering into partnerships, licenses, or other arrangements with third parties; and reducing the exercise price of outstanding warrants. Any one of these measures could substantially reduce the value to us of our technology and its commercial potential. If we issue equity, debt or convertible securities to raise additional funds, our existing stockholders may experience dilution, and the new equity, debt or convertible securities may have rights, preferences and privileges senior to those of our existing stockholders. There is no guarantee that we would be able to obtain capital on terms acceptable to us, or at all.

If we are unable to obtain sufficient capital, it would have a material adverse effect on our business and operations. It could cause us to fail to execute our business plan, fail to take advantage of future opportunities, or fail to respond to competitive pressures or customer requirements. It also may require us to delay, scale back or eliminate some or all of our research and development programs, to license to third parties the right to commercialize products or technologies that we would otherwise commercialize ourselves, or to reduce or cease operations. If adequate funds are not available when needed, we may be required to significantly modify our business model and operations to reduce spending to a sustainable level.

We believe our current efforts to raise capital, our current efforts to market and sell our products, and our ability to significantly reduce expenses, will provide sufficient cash resources to satisfy our needs over the next 12 months. However, we do not yet have, and we may never have, significant cash inflows from product sales or from other sources of revenue to offset our ongoing and planned investments in corporate infrastructure, research and development projects, regulatory submissions, business development activities, and sales and marketing, among other investments. Some or all of our ongoing or planned investments may not be successful. In addition, irrespective of our cash resources, we may be contractually or legally obligated to make certain investments which cannot be postponed.

## 2. Summary of Significant Accounting Policies

### Basis of Presentation

The accompanying consolidated financial statements include the consolidated accounts of Pure Bioscience, Inc. and its wholly owned subsidiary, ETIH2O Corporation, a Nevada corporation. ETIH2O Corporation has no business and no material assets or liabilities and there have been no significant transactions related to ETIH2O during the periods presented in the consolidated financial statements. All inter-company balances and transactions have been eliminated.

### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, or GAAP, requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements, and the disclosures made in the accompanying notes to the consolidated financial statements. Actual results could differ materially from those estimates.

### Reclassification

Certain reclassifications have been made to prior period amounts to conform to current period presentation. These reclassifications did not have an impact on our results of operations or financial condition as of and for the years ended July 31, 2012 and 2011.

### Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid investments with original maturities from purchase date of three months or less.

### Fair Value of Financial Instruments

Certain of our financial instruments—including cash and cash equivalents, accounts receivable, inventories, prepaid expenses, accounts payable, accrued liabilities and deferred revenue—are carried at cost, which is considered to be representative of their respective fair values because of the short-term nature of these instruments. Our loan payable and derivative liability are carried at estimated fair value (Note 6).

### Derivative Financial Instruments

We do not use derivative instruments to hedge exposures to cash flow or market or foreign currency risks.

We review the terms of the common stock, warrants and convertible debt we issue to determine whether there are derivative instruments, including embedded conversion options that are required to be bifurcated and accounted for separately as derivative financial instruments. In circumstances where the host instrument contains more than one embedded derivative instrument, including a conversion option, that is required to be bifurcated, the bifurcated derivative instruments are accounted for as a single, compound derivative instrument.

Derivatives are initially recorded at fair value and are then revalued at each reporting date with changes in the fair value reported as non-operating income or expense. When the equity or convertible debt instruments contain embedded derivative instruments that are to be bifurcated and accounted for as liabilities, the total proceeds received are first allocated to the fair value of all the bifurcated derivative instruments. The remaining proceeds, if any, are then allocated to the host instruments themselves, usually resulting in those instruments being recorded at a discount from their face value.

The discount from the face value of any convertible debt, together with the stated interest on the instrument, is amortized over the life of the instrument through periodic charges to interest expense, using the effective interest method.

#### Accounts Receivable

Trade accounts receivable are recorded net of allowances for doubtful accounts. Estimates of allowances for doubtful accounts are determined based on historical payment patterns and individual customer circumstances. The allowance for doubtful accounts was zero at July 31, 2012 and 2011.

Included in accounts receivable at July 31, 2012 is \$273,000 billed to one customer for product shipped, where payment on agreed terms was not reasonably assured at the time of shipment. We recognized this amount, less our costs associated with the shipment, as deferred revenue on the consolidated balance sheet at July 31, 2012.

#### Inventories

Inventories are stated at the lower of cost or net realizable value, and net of a valuation allowance for potential excess or obsolete material. Cost is determined using the average cost method.

F-8

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#### Property, Plant and Equipment

Property, plant and equipment is stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The estimated useful lives of our property, plant, and equipment range from three to ten years. Capitalized costs associated with leasehold improvements are depreciated over the lesser of the useful life of the asset or the remaining life of the lease. Depreciation is generally included in selling, general and administrative expense. Depreciation related to manufacturing is systematically allocated to inventory produced, and expensed through cost of goods sold at the time inventory is sold.

#### Patents

We have filed a number of patent applications with the United States Patent and Trademark Office and in foreign countries. Certain legal and related costs incurred in connection with pending patent applications have been capitalized. Costs related to successful patent applications are amortized over the lesser of the remaining useful life of the related technology or the remaining patent life, commencing on the date the patent is issued. Capitalized costs related to patent applications are expensed as a selling, general and administrative expense in the period in which a determination is made not to pursue such applications.

#### Impairment of Long-Lived Assets

In accordance with GAAP, if indicators of impairment exist, we assess the recoverability of the affected long-lived assets by determining whether the carrying value of such assets can be recovered through undiscounted future operating cash flows. If impairment is indicated, we measure the amount of such impairment by comparing the carrying value of the asset to the fair value of the asset and we record the impairment as a reduction in the carrying value of the related asset and a charge to operating results. Estimating the undiscounted future cash flows associated with long-lived assets requires judgment, and assumptions could differ materially from actual results. During the years ended July 31, 2012 and 2011, no impairment of long-lived assets was indicated or recorded.

#### Revenue Recognition

We sell our products to distributors and end users. We record revenue when we sell products to our customers, rather than when our customers resell products to third parties. When we sell products to our customers, we reduce the balance of our inventory with a corresponding charge to cost of goods sold. We do not currently have any consignment sales.

Product sales are recognized when delivery of the products has occurred, title has passed to the customer, the selling price is fixed or determinable, collectability is reasonably assured and we have no further obligations. Any amounts received prior to satisfying these revenue recognition criteria are recorded as deferred revenue. We record product sales net of discounts at the time of sale and report product sales net of such discounts.

We also license our products and technology to development and commercialization partners. Upfront product and technology license fees under multiple-element arrangements are deferred and recognized over the period of such services or performance, if such arrangements require on-going services or performance. Non-refundable amounts received for substantive milestones are recognized upon achievement of the milestone. Any amounts received prior to satisfying these revenue recognition criteria are recorded as deferred revenue.

#### Shipping and Handling Costs

Shipping and handling costs incurred by us for product shipments are included in cost of goods sold.

#### Research and Development Costs

Research and development costs are expensed as incurred.

#### Share-Based Compensation

We grant equity-based awards under share-based compensation plans. We estimate the fair value of share-based payment awards using the Black-Scholes option valuation model. This fair value is then amortized over the requisite service periods of the awards. The Black-Scholes option valuation model requires the input of subjective assumptions, including price volatility of the underlying stock, risk-free interest rate, dividend yield, and expected life of the option. Share-based compensation expense is based on awards ultimately expected to vest, and therefore is reduced by expected forfeitures.

#### Other Income (Expense)

We record interest income, interest expense, change in derivative liabilities, as well as other non-operating transactions, as other income (expense) on our consolidated statements of operations.

#### Comprehensive Loss

Comprehensive loss is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources, including unrealized gains and losses on marketable securities and foreign currency translation adjustments. For the years ended July 31, 2012 and 2011, our comprehensive loss consisted only of net loss.



### Income Taxes

We recognize deferred tax assets and liabilities for temporary differences between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements based upon the enacted tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is established to reduce deferred tax assets to the amount expected to be realized.

### Net Loss Per Share

Basic net loss per common share is computed as net loss divided by the weighted average number of common shares outstanding for the period. Our diluted net loss per common share is the same as our basic net loss per common share because we incurred a net loss during each period presented, and the potentially dilutive securities from the assumed exercise of all outstanding stock options, warrants and convertible notes would have an antidilutive effect. As of July 31, 2012 and 2011, the number of shares issuable upon the exercise of stock options, warrants, and convertible notes and shares held in escrow was 1,757,283 and 526,168, respectively.

### Recent Accounting Pronouncements

No recent accounting pronouncements or other authoritative guidance have been issued that are considered likely to have a material impact on our consolidated financial statements.

### 3. Balance Sheet Details

Inventories consist of the following:

|                | July 31,  |           |
|----------------|-----------|-----------|
|                | 2012      | 2011      |
| Raw materials  | \$476,000 | \$498,000 |
| Finished goods | 178,000   | 363,000   |
|                | \$654,000 | \$861,000 |

Property, plant, and equipment consist of the following:

|                               | July 31,     |              |
|-------------------------------|--------------|--------------|
|                               | 2012         | 2011         |
| Computers and equipment       | \$909,000    | \$899,000    |
| Furniture and fixtures        | 21,000       | 21,000       |
| Leasehold improvements        | 622,000      | 622,000      |
|                               | 1,552,000    | 1,542,000    |
| Less accumulated depreciation | (1,295,000 ) | (1,116,000 ) |
|                               | \$257,000    | \$426,000    |

Depreciation expense was \$179,000 and \$285,000 for the years ended July 31, 2012 and 2011, respectively.

Patents consist of the following:

|                               | July 31,     |              |
|-------------------------------|--------------|--------------|
|                               | 2012         | 2011         |
| Patents                       | \$3,773,000  | \$3,534,000  |
| Less accumulated amortization | (1,823,000 ) | (1,617,000 ) |
|                               | \$1,950,000  | \$1,917,000  |

Patent amortization expense was \$206,000 and \$186,000 for the years ended July 31, 2012 and 2011, respectively. At July 31, 2012, the weighted average remaining amortization period for all patents was approximately ten years. The annual patent amortization expense for the next five years is estimated to be approximately \$226,000 per year.

F-10

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#### 4. Secured Convertible Note

Pursuant to a securities purchase agreement entered into on June 26, 2012, on July 10, 2012 we received an aggregate of \$1,200,000 in cash consideration from nine lenders in exchange for our issuance to such lenders of secured convertible promissory notes, or the Notes, in an aggregate principal amount of \$1,333,000. We refer to such transaction as the "Bridge Loan". Pursuant to the terms of the Notes and the other agreements (as amended) entered in connection with the Bridge Loan, or the Loan Agreements, all amounts owed thereunder become due and payable on the earlier of (i) December 26, 2012 or (ii) our closing of any financing transaction or series of financing transactions that in the aggregate raise \$1,200,000 or more in proceeds for the Company. Subsequent to July 31, 2012, we repaid all amounts owed under the Bridge Loan (Note 12).

The terms of the Notes provide for an interest rate of 0% during their term, a late fee at a rate of 10% if we fail to repay all amounts owed thereunder when due or if a prior event of default occurs, and an interest rate of 18% per annum commencing five days after the occurrence of an event of default that results in the acceleration of amounts owed thereunder. In accordance with authoritative guidance, we imputed interest on the Bridge Loan at the rate of 10% per annum. As a result, the fair value at issuance was \$1,270,000, net of imputed interest of \$63,000.

While outstanding, the Notes were secured by a lien on all of our assets pursuant to a security agreement entered in connection with the Bridge Loan, and 575,000 shares of our common stock (later reduced to 500,000 shares pursuant to an amendment effective September 6, 2012), which shares were issued in the name of an escrow agent as additional collateral for the timely repayment of the Notes and will be cancelled pursuant to our full repayment of the Bridge Loan. Additionally, the Notes could be converted into shares of our common stock if the entire balance owed thereunder was not repaid by December 26, 2012 or an earlier event of default occurred. The conversion price of the Notes as of July 31, 2012 was \$3.28 per share, subject to adjustment as set forth in the Notes, including adjustment of the conversion price to the sale price to the public of shares of our common stock issued in a registered public offering, if lower, closed within the 60-day period commencing on June 26, 2012, if any. We analyzed the nature of the conversion terms of the Notes and determined that the conversion feature requires derivative liability classification in accordance with authoritative guidance (See Note 5). At issuance, the fair value of the conversion feature totaled \$33,000. The fair value was recorded as a debt discount and will be amortized over the term of the Bridge Loan to interest expense.

As further consideration to the lenders for the Bridge Loan in addition to our issuance of the Notes, we issued to each such lender: (i) an aggregate amount of 54,878 shares of our common stock, which was valued at \$166,000 and recorded as a deferred asset and will be amortized to interest expense over the term of the Bridge Loan, and (ii) warrants to acquire up to an aggregate amount of 128,046 shares of our common stock, which warrants have a four-year term, become exercisable six months after the date of their issuance, and had an exercise price upon issuance of \$3.28 per share, which exercise price is subject to anti-dilution provisions that require derivative liability classification (See Note 5). Additionally, we issued to the placement agent warrants to acquire up to an aggregate amount of 4,374 shares of our common stock, which warrants have the same terms as the warrants issued to the lenders in the Bridge Loan transaction. At issuance, the fair value of the 132,420 warrants issued in connection with the Bridge Loan transaction totaled \$297,000. The warrant fair value was recorded as a debt discount and will be amortized over the term of the Bridge Loan to interest expense.

Amortization of debt discounts related to the Bridge Loan, including imputed interest, the original issue discount, the conversion feature, and the warrants, was \$91,000 for the year ended July 31, 2012.

Total fees associated with the Bridge Loan were \$267,000. Of that amount, \$166,000 relates to the fair value of 54,878 shares of common stock issued to the lenders, and \$2,000 relates to the fair value of 625 shares of common stock issued to the placement agent for the Bridge Loan. All fees were capitalized as a deferred asset included in prepaid expenses, and will be amortized to interest expense over the term of the Bridge Loan. During the year ended

July 31, 2012, \$53,000 of deferred financing fees were amortized to interest expense.

F-11

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The following table summarizes information relative to all of the outstanding notes at July 31, 2012 and 2011:

|                                     | July 31,    |      |
|-------------------------------------|-------------|------|
|                                     | 2012        | 2011 |
| Convertible notes                   | \$1,282,000 | \$-  |
| Less unamortized discounts:         |             |      |
| Original issue discount             | (56,000 )   | -    |
| Detachable warrants discount        | (238,000 )  | -    |
| Conversion feature discount         | (26,000 )   | -    |
| Convertible notes, net of discounts | \$962,000   | \$-  |

#### 5. Derivative Liability

We accounted for the warrants issued in conjunction with the Bridge Loan, and the embedded conversion feature of the Notes, in accordance with the accounting guidance for derivatives. The applicable accounting guidance sets forth a two-step model to be applied in determining whether a financial instrument is indexed to an entity's own stock, which would qualify such financial instruments for a scope exception. This scope exception specifies that a contract that would otherwise meet the definition of a derivative financial instrument would not be considered as such if the contract is both (i) indexed to the entity's own stock and (ii) classified in the stockholders' equity section of the entity's balance sheet. We determined the warrants and the conversion feature of the Notes are ineligible for equity classification due to anti-dilution provisions set forth therein.

We recorded the fair value of the warrants issued in connection with the Bridge Loan as a warrant liability due to anti-dilution provisions requiring the strike price of the warrants to be adjusted if we subsequently issue common stock at a lower stock price. The fair value of the warrants at June 26, 2012 and July 31, 2012 was \$297,000 and \$286,000, respectively. The fair value decrease of \$11,000 was recorded as a change in derivative liability in the consolidated statement of operations.

Based on our assessment of the Notes, we determined that the conversion feature represented an embedded derivative liability. Accordingly, we bifurcated the embedded conversion feature and accounted for it separately as a derivative liability. Under the terms of the Notes, if we sell shares of our common stock to the public in a registered public offering at a price per share less than \$3.28 during the 60-day period commencing on June 26, 2012, then the conversion price of the Notes will be reduced to equal the price per share at which shares were sold to the public in such registered public offering. The fair value of the conversion feature at June 26, 2012 and July 31, 2012 was \$33,000 and \$33,000 respectively.

The estimated fair values of the warrant and conversion feature were computed by a third party using a Monte Carlo option pricing model based the following assumptions:

|                         | June 26, 2012    |   | July 31, 2012    |   |
|-------------------------|------------------|---|------------------|---|
| Volatility              | 85.0             | % | 85.0             | % |
| Risk-free interest rate | 0.53             | % | 0.53             | % |
| Dividend yield          | 0.0              | % | 0.0              | % |
| Expected life           | 0.50 - 4.5 years |   | 0.42 - 4.4 years |   |

## 6. Fair Value of Financial Instruments

Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the authoritative guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.
- Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

In connection with the Bridge Loan, we issued warrants and convertible notes that are accounted for as derivative liabilities.

We used Level 3 inputs for the valuation methodology of the derivative liabilities. The estimated fair values were computed by a third party using a Monte Carlo option pricing model based on various assumptions. Our derivative liabilities are adjusted to reflect estimated fair value at each period end, with any decrease or increase in the estimated fair value being recorded in other income or expense accordingly, as adjustments to the fair value of the derivative liabilities.

The following table provides a reconciliation of the beginning and ending balances of the derivative liabilities for the year ended July 31, 2012:

### Fair Value of Significant Unobservable Inputs (Level 3)

|                                     | Warrant<br>Liability | Conversion<br>Feature<br>Liability | Total     |
|-------------------------------------|----------------------|------------------------------------|-----------|
| Beginning balance July 31, 2011     | \$-                  | \$-                                | \$-       |
| Issuances                           | 297,000              | 33,000                             | 330,000   |
| Adjustments to estimated fair value | (11,000)             | -                                  | (11,000)  |
| Ending balance July 31, 2012        | \$286,000            | \$33,000                           | \$319,000 |

## 7. Commitments and Contingencies

We lease our primary facility in El Cajon, California under a noncancelable operating lease that expires in December 2014. This facility includes our corporate offices, research and development laboratory, manufacturing operations, and warehouse. We lease additional warehouse space under a noncancelable operating lease that expires in November 2012. We also lease other office and warehouse space on a month to month basis. Rent expense for all of our facilities, including office and warehouse space, was \$275,000 and \$298,000 for the years ended July 31, 2012 and 2011, respectively.

Future minimum annual lease payments for our facility leases for years ending after at July 31, 2012 are as follows:

|      |            |
|------|------------|
| 2013 | \$ 150,000 |
| 2014 | 168,000    |
| 2015 | 71,000     |
| 2016 | -          |
| 2017 | -          |
|      | \$ 389,000 |

F-13

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## 8. Stockholders' Equity

### Reverse Stock Split

Effective on August 14, 2012 and commencing with the opening of trading on August 15, 2012, we effected a reverse stock split of our issued and outstanding common stock at a ratio of one-for-eight. All information in our consolidated financial statements and the notes thereto regarding share amounts of our common stock and prices per share of our common stock has been adjusted to reflect the application of the reverse stock split on a retroactive basis, unless otherwise noted. See Note 1 and Note 12 for additional information.

### Reincorporation

In March 2011, we reincorporated in the state of Delaware. As a result, our authorized capital stock now consists of 5,000,000 shares of preferred stock with a par value of \$0.01 per share, and 100,000,000 shares of common stock with a par value of \$0.01 per share. Previously we were incorporated in the state of California, and our authorized capital stock consisted of 5,000,000 shares of preferred stock with no par value, and 50,000,000 shares of common stock with no par value. Other than the change in the state of incorporation, the increase in authorized common stock, and the establishment of par values for our capital stock, our reincorporation did not result in any change in the business, physical location, management, assets, liabilities or net worth, nor did it result in any change in location of our employees, including our management. The stockholders' equity section of the accompanying consolidated financial statements has been restated retroactively to give effect to the reincorporation. The reclassification had no effect on the results of operations or the total amount of stockholders' equity.

### Preferred Stock

As of July 31, 2012, the Company's Board of Directors is authorized to issue 5,000,000 shares of preferred stock with a par value of \$0.01 per share, in one or more series. As of July 31, 2012 and 2011, there were no shares of preferred stock issued and outstanding.

### Common Stock

In October 2010, we completed a private placement of 135,000 newly issued unregistered shares of our common stock at a price of \$17.60 per share. The net proceeds from the private placement were \$2,367,000. In addition, during the year ended July 31, 2011, certain of our officers and directors elected to net exercise options to purchase an aggregate of 36,250 shares of our common stock, pursuant to the terms of the applicable option agreements therefor, which resulted in our issuance of an aggregate of 27,538 shares of our common stock for no cash consideration to us.

In April 2011, we entered into a sales agreement with an investment banking firm. On December 14, 2011, we terminated such sales agreement and, consequently, there have been no sales of our common stock under the sales agreement since its termination. Under the terms of the sales agreement, we were permitted to offer and sell shares of our common stock having an aggregate offering price of up to \$7,000,000. The sales were made, from time to time, through the investment bank in "at the market" offerings, as defined by the Securities and Exchange Commission, or the SEC, and were made pursuant to our then-effective shelf registration statement previously filed with the SEC, which expired on May 8, 2012. During the year ended July 31, 2012, we sold 167,136 shares of our common stock pursuant to the sales agreement for net proceeds of \$949,000. During the year ended July 31, 2011, we sold 329,571 shares of our common stock pursuant to the sales agreement for net proceeds of \$3,065,000.

On October 24, 2011, we entered into a one year service agreement for investor relations services. We issued 18,750 shares of our common stock, with a value of \$97,000, for these services. The value was capitalized to prepaid expenses and is being amortized over the term of the agreement. During the year ended July 31, 2012, we recognized \$73,000 of expense related to these services.

On December 14, 2011, we entered into a purchase agreement, or the \$7.5M Purchase Agreement, and a related registration rights agreement with Lincoln Park Capital Fund, LLC, or Lincoln Park, pursuant to which Lincoln Park



agreed to purchase from us up to \$7,500,000 in shares of our common stock subject to the satisfaction of certain conditions, including the SEC declaring effective a registration statement for the resale of such shares. On April 10, 2012, we filed the resale registration statement with the SEC, but it was not declared effective and we filed with the SEC on June 28, 2012 a request for the withdrawal of that registration statement. On May 18, 2012, we delivered notice to Lincoln Park of our termination of the \$7.5M Purchase Agreement and, consequently, there have been, and there will be, no sales of our common stock to Lincoln Park under the \$7.5M Purchase Agreement. As consideration for its commitment to purchase shares of our common stock pursuant to the \$7.5M Purchase Agreement, in December 2011, we issued to Lincoln Park 58,838 shares of our common stock as restricted securities.

F-14

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On December 15, 2011, we entered into an additional purchase agreement, or the \$2.5M Purchase Agreement, with Lincoln Park, pursuant to which Lincoln Park agreed to purchase from us up to \$2,500,000 in shares of our common stock. Under the terms of the \$2.5M Purchase Agreement, the shares were to be sold to Lincoln Park from time to time at a purchase price per share based on the prevailing market prices of our common stock and were registered pursuant to our then-effective shelf registration statement previously filed with the SEC, as supplemented by our registration statement on Form S-3MEF. That shelf registration statement expired on May 8, 2012, and on May 18, 2012, concurrently with our notice of termination of the \$7.5M Purchase Agreement, we delivered notice to Lincoln Park of our termination of the \$2.5M Purchase Agreement. Accordingly, since the date of the notice, there have been, and there will be, no further sales of our common stock to Lincoln Park under the \$2.5M Purchase Agreement. As consideration for its commitment to purchase shares of our common stock under the \$2.5M Purchase Agreement, in December 2011, we issued to Lincoln Park an additional 19,613 shares of our common stock. Such shares were registered pursuant to our then-effective shelf registration statement. During the year ended July 31, 2012, we sold 718,463 shares of our common stock to Lincoln Park pursuant to the \$2.5M Purchase Agreement. Net proceeds from the sale of these shares were \$1,719,000.

In connection with our agreements with Lincoln Park, we have fully amortized the deferred offering costs of \$424,000. Of this amount, \$128,000 represents fees associated with the offering, and \$296,000 represents the fair market value of the 78,451 shares of our common stock issued to Lincoln Park as commitment shares. Upon termination of the \$7.5M Purchase Agreement and the \$2.5M Purchase Agreement, we expensed the remaining deferred offering costs of \$287,000. Of that amount, \$241,000 represents the unamortized fair value of the commitment shares issued to Lincoln Park.

In connection with the sale of our common stock to Lincoln Park pursuant to the \$2.5M Purchase Agreement and the \$7.5M Purchase Agreement, we agreed to pay a cash fee to Wharton Capital Markets LLC, or Wharton, pursuant to an engagement letter dated December 8, 2011, in an amount equal to 6% of the aggregate gross proceeds to us from the issuance and sale of shares pursuant to our agreements with Lincoln Park. The total fees recognized during the fiscal year ended July 31, 2012 were \$122,000. Such amounts became due and payable to Wharton at the time that we actually received funds from Lincoln Park pursuant to our agreements with Lincoln Park, subject to our receipt of written confirmation that the Corporate Finance Department of the Financial Industry Regulatory Authority, Inc., or FINRA, had determined not to raise any objection with respect to the fairness or reasonableness of the compensation terms of our arrangement with Wharton. We have received no funds from Lincoln Park since our last sale of our common stock to Lincoln Park under the \$2.5M Purchase Agreement and, because there will be no further sales of our common stock under either of the purchase agreements with Lincoln Park, no additional amounts will be paid to Wharton pursuant to the engagement letter. The engagement letter also provided that we issue to Wharton a warrant, or the Warrant, to purchase 25,000 shares of our common stock with an exercise price of 110% of the closing sale price of our common stock on the date of the issuance of the Warrant, subject to our receipt of no-objection confirmation from FINRA as described above. On February 3, 2012, we received that written confirmation from FINRA and, consequently, issued to Wharton the Warrant as of that date at an exercise price of \$3.608 per share. We determined that the Warrant was an equity instrument and did not represent a derivative instrument. A fair value of \$53,000 was estimated for the Warrant using the Black-Sholes valuation method using a volatility of 82.95%, an interest rate of 0.85% and a dividend yield of zero. Neither the Warrant issued to Wharton nor the shares to be issued upon exercise thereof have been or are to be registered for sale or resale under the Securities Act of 1933, or the Securities Act, and will be issued in reliance on an exemption from registration thereunder pursuant to Section 4(2) thereof.

On April 10, 2012, we entered into a four-month agreement with a consultant for investor relations services. We issued 20,000 shares of our common stock to the consultant, with a value of \$45,000, for these services. The value was capitalized to prepaid expenses and is being amortized over the term of the agreement. During the year ended July 31, 2012, we recognized the entire \$45,000 of expense related to these services.

On June 4, 2012, we issued an aggregate of 250,000 shares of our common stock to three separate investors pursuant to agreements entered with each such investor on May 16, 2012, May 17, 2012 and May 23, 2012. The shares were sold at a price of \$2.00 per share, resulting in approximately \$500,000 in aggregate gross proceeds to us. The shares have not been, nor will they be, registered under the Securities Act or any state securities laws and have been issued in reliance on an exemption from the registration requirements of the Securities Act afforded by Section 4(2) thereof.

Pursuant to an agreement entered into on June 26, 2012, on July 10, 2012 we received an aggregate of \$1,200,000 in cash consideration from nine lenders in exchange for our issuance to such lenders of the Notes in an aggregate principal amount of \$1,333,000 in the Bridge Loan transaction. In connection with the Bridge Loan, we issued to each such lender: (i) an aggregate amount of 54,878 shares of our common stock, which was valued at \$166,000 and recorded as a deferred asset and will be amortized to interest expense over the term of the Bridge Loan, and (ii) warrants to acquire up to an aggregate amount of 128,046 shares of our common stock, which warrants have a four-year term, become exercisable six months after the date of their issuance, and had an exercise price upon issuance of \$3.28 per share, which exercise price is subject to anti-dilution provisions that require derivative liability classification (See Note 4 and Note 5). Additionally, we issued to the placement agent 625 shares of common stock and warrants to acquire up to an aggregate amount of 4,374 shares of our common stock, which warrants have the same terms as the warrants issued to the lenders in the Bridge Loan transaction. At issuance, the fair value of all of the warrants issued in connection with the Bridge Loan totaled \$297,000.

On June 29, 2012, we entered into a common stock purchase agreement with fifteen investors, pursuant to which we issued and sold to such investors an aggregate of 325,125 shares of our common stock and warrants to purchase up to an aggregate of 81,280 shares of our common stock. The shares were sold to the investors at a price of \$2.00 per share, resulting in gross proceeds to us of approximately \$650,000. The warrants issued to such investors have a three-year term, become exercisable six months after the date of their issuance, and have an exercise price of \$3.52 per common share. We determined that the warrants issued in connection with this private placement were equity instruments and did not represent derivative instruments. A fair value of \$80,000 was estimated for the warrants using the Black-Sholes valuation method using a volatility of 82.44%, an interest rate of 0.24% and a dividend yield of zero. The investors have certain piggyback registration rights with respect to the shares sold pursuant to the common stock purchase agreement, the warrants and the shares issuable upon exercise of the warrants, which rights are subject to certain conditions and limitations set forth in such agreement. None of the securities sold to such investors have been registered under the Securities Act or any state securities laws and have been issued in reliance on an exemption from the registration requirements of the Securities Act afforded by Section 4(2) thereof and Regulation D promulgated thereunder.

#### Warrants

A summary of our warrant activity and related data is as follows:

|                              | Shares    |
|------------------------------|-----------|
| Outstanding at July 31, 2010 | 236,181   |
| Issued                       | -         |
| Exercised                    | (15,420 ) |
| Expired                      | (32,148 ) |
| Outstanding at July 31, 2011 | 188,613   |
| Issued                       | 238,699   |
| Exercised                    | -         |
| Expired                      | -         |
| Outstanding at July 31, 2012 | 427,312   |

The following table summarizes information related to warrants outstanding at July 31, 2012:

| Expiration Date | Exercise Price | Shares  |
|-----------------|----------------|---------|
| 10/19/12        | \$68.80        | 20,967  |
| 10/19/12        | \$57.36        | 52,411  |
| 05/07/14        | \$16.50        | 11,363  |
| 05/27/14        | \$18.96        | 45,503  |
| 05/27/14        | \$21.12        | 5,532   |
| 03/03/15        | \$16.80        | 52,836  |
| 01/13/16        | \$3.52         | 81,280  |
| 12/14/16        | \$3.61         | 25,000  |
| 12/24/16        | \$3.28         | 132,420 |
|                 |                | 427,312 |

We received cash from the exercise of warrants of zero and \$259,000 for the years ended July 31, 2012 and 2011, respectively.

#### Stock Option Plans

In 2007, we adopted the PURE Bioscience 2007 Equity Incentive Plan, or the Plan, which provides for the grant of incentive and non-qualified stock options, as well as other share-based payment awards, to our employees, directors,

consultants and advisors. These awards have up to a 10-year contractual life and are subject to various vesting periods, as determined by the Compensation Committee or the Board of Directors. The Plan is the only active plan pursuant to which options to acquire common stock or restricted stock awards can be granted and are currently outstanding. As of July 31, 2012, there were approximately 222,300 shares of our common stock available for issuance under the Plan.

A summary of our stock option activity and related data is as follows:

|                              | Shares     | Weighted-Average Exercise Price | Aggregate Intrinsic Value |
|------------------------------|------------|---------------------------------|---------------------------|
| Outstanding at July 31, 2010 | 723,251    | \$ 17.01                        | \$ 5,070,000              |
| Granted                      | 75,625     | \$ 9.56                         |                           |
| Exercised                    | (84,372 )  | \$ 5.11                         |                           |
| Cancelled                    | (376,978 ) | \$ 14.58                        |                           |
| Outstanding at July 31, 2011 | 337,526    | \$ 21.02                        | \$ 30,000                 |
| Granted                      | 40,625     | \$ 6.68                         |                           |
| Exercised                    | -          | \$ -                            |                           |
| Cancelled                    | (29,688 )  | \$ 22.05                        |                           |
| Outstanding at July 31, 2012 | 348,463    | \$ 19.26                        | \$ -                      |

The weighted-average remaining contractual term of options outstanding at July 31, 2012 was approximately 5.9 years.

At July 31, 2012, 272,457 options were exercisable. These options had a weighted-average exercise price of \$19.46, an aggregate intrinsic value of zero, and a weighted average remaining contractual term of approximately 5.8 years.

The intrinsic value of all options exercised was \$1,089,000 for the year ended July 31, 2011. We received cash from the exercise of stock options of \$278,000 for the year ended July 31, 2011. Additionally, included within the options exercised during the year ended July 31, 2011, there was net exercise of an aggregate of 36,250 options, which resulted in the issuance of 27,538 shares of our common stock. No options were exercised during the year ended July 31, 2012. The weighted-average grant date fair value of equity options granted during the years ended July 31, 2012 and 2011 was \$4.11 and \$4.70, respectively.

A summary of our restricted stock activity and related data is as follows:

|                              | Shares  |
|------------------------------|---------|
| Outstanding at July 31, 2010 | 7,650   |
| Granted                      | 4,986   |
| Vested                       | (7,650) |
| Forfeited                    | -       |
| Outstanding at July 31, 2011 | 4,986   |
| Granted                      | 6,852   |
| Vested                       | (4,986) |
| Forfeited                    | -       |
| Outstanding at July 31, 2012 | 6,852   |

## 9. Share-Based Compensation

We recognize compensation expense for stock option awards on a straight-line basis over the applicable service period of the award. The service period is generally the vesting period, with the exception of options granted subject to a consulting agreement, whereby the option vesting period and the service period defined pursuant to the terms of the consulting agreement may be different. Stock options issued to consultants are revalued quarterly until fully vested, with any change in fair value expensed. The following methodology and assumptions were used to calculate share based compensation for the years ended July 31, 2012 and 2011:

|                         | For the years ended July 31, |                     |
|-------------------------|------------------------------|---------------------|
|                         | 2012                         | 2011                |
| Volatility              | 81.05% -<br>89.77 %          | 80.01% -<br>87.16 % |
| Risk-free interest rate | 0.18% -<br>1.32 %            | 0.50% -<br>2.14 %   |
| Dividend yield          | 0.0 %                        | 0.0 %               |
| Expected life           | 4 years                      | 5 years             |

Volatility is the measure by which our stock price is expected to fluctuate during the expected term of an option. Volatility is derived from the historical daily change in the market price of our common stock, as we believe that historical volatility is the best indicator of future volatility.

The risk-free interest rates used in the Black-Scholes calculations are based on the prevailing U.S. Treasury yield as determined by the U.S. Federal Reserve.

We have never paid dividends on our common stock and do not anticipate paying dividends on our common stock in the foreseeable future. Accordingly, we have assumed no dividend yield for purposes of estimating the fair value of our share-based compensation.

The expected life of our options is determined following the guidance of Staff Accounting Bulletin No. 107 and Staff Accounting Bulletin No. 110. We follow the simplified method to determine the expected term of options issued to employees and directors. Under the simplified method, the expected term is presumed to be the mid-point between the vesting date and the end of the contractual term. The expected term for options issued to consultants is the contractual term. We periodically evaluate our historical data as a basis for determining the expected terms of such options.

Stock-based compensation expense is based on awards ultimately expected to vest, and therefore is reduced by expected forfeitures.

The following table summarizes share-based compensation expense related to employee and director stock options, consulting stock options, and restricted stock awards, for the years ended July 31, 2012 and 2011:

|   | For the years ended July 31, |              |
|---|------------------------------|--------------|
|   | 2012                         | 2011         |
| Share-based compensation for employees and directors: |                              |              |
| Selling, general and administrative                   | \$ 825,000                   | \$ 1,032,000 |
| Research and development                              | 257,000                      | 127,000      |
|   | 1,082,000                    | 1,159,000    |
| Share-based compensation for consultants:             |                              |              |

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|  |              |              |
|--|--------------|--------------|
| Selling, general and administrative    | (5,000 )     | 41,000       |
| Research and development               | -            | (6,000 )     |
|  | (5,000 )     | 35,000       |
| <hr/>                                  |              |              |
| Total share-based compensation expense | \$ 1,077,000 | \$ 1,194,000 |

As of July 31, 2012, there was \$1,103,000 of unrecognized non-cash compensation cost related to unvested options, which will be recognized over a weighted average period of 1.35 years. Also, as of July 31, 2012, there was \$19,000 of unrecognized non-cash compensation cost related to unvested restricted shares, which will be recognized over a weighted average period of 1 year.



## 10. Sales Concentration

Net product sales were \$812,000 and \$454,000 for the years ended July 31, 2012 and 2011, respectively. For the year ended July 31, 2012, two customers accounted for 67% of our net product sales. No other individual customer accounted for 10% or more of our net product sales. The geographic breakdown of net product sales was as follows: 92% U.S. and 8% foreign. For the year ended July 31, 2011, one customer accounted for 46% of our net product sales. No other individual customer accounted for 10% or more of our net product sales. The geographic breakdown of net product sales was as follows: 87% U.S. and 13% foreign.

## 11. Income Taxes

We file federal and California consolidated tax returns with our subsidiaries. Our income tax provision for the year ended July 31, 2012 was \$5,000 and for the year ended July 31, 2011 was \$2,000; the minimum state franchise taxes we pay regardless of income or loss.

At July 31, 2012, we had federal and California tax net operating loss carry-forwards of approximately \$70.7 million and \$60.0 million, respectively. Included in these net operating loss carry-forwards is \$17.3 million related to a deduction for income tax purposes for which the Company has not realized a tax benefit. In future periods an adjustment would be recorded to Additional Paid in Capital at the time that these net operating losses may be utilized and reduce income tax. At July 31, 2011, we had federal and California tax net operating loss carry-forwards of approximately \$64.7 million and \$54.6 million, respectively. Utilization of the net operating loss carry-forwards may be subject to a substantial annual limitation due to ownership change limitations that may have occurred or that could occur in the future, as required by Section 382 of the Internal Revenue Code as well as similar state provisions. These ownership changes may limit the amount of net operating loss carry-forwards that can be utilized annually to offset future taxable income and tax, respectively. In general, an ownership change, as defined by Section 382 of the Internal Revenue Code results from a transaction or series of transactions over a three-year period resulting in an ownership change of more than 50 percentage points of the outstanding stock of a company by certain stockholders or public groups. Since our formation, we have raised capital through the issuance of capital stock on several occasions (both before and after our initial public offering in 1996) which, combined with the purchasing stockholders' subsequent disposition of those shares, may have resulted in such an ownership change, or could result in an ownership change in the future upon subsequent disposition. While we do not believe that we have experienced an ownership change, the pertinent tax rules related thereto are complex and subject to varying interpretations, and thus complete assurance cannot be provided that the taxing authorities would not take an alternative position.

Our current federal tax loss carry-forwards began expiring in the year ended July 31, 2011 and, unless previously utilized, will completely expire in the year ending July 31, 2031. In the two fiscal years ending July 31, 2013 and 2014, \$1.9 million of our federal net operating loss carry-forwards will expire, and the balance of our current federal net operating loss carry-forwards will expire between July 31, 2018 and July 31, 2031. Our California tax loss carry-forwards will begin to expire in the year ending July 31, 2014, and will completely expire in the year ending July 31, 2031.

Significant components of our deferred tax assets are as follows:

|   | July 31,      |               |
|---|---------------|---------------|
|   | 2012          | 2011          |
| Net operating loss carry-forward            | \$ 20,677,000 | \$ 18,327,000 |
| Stock options and warrants                  | 1,765,000     | 1,558,000     |
| Other temporary differences                 | 118,000       | 18,000        |
| Total deferred tax assets                   | 22,560,000    | 19,903,000    |
| Valuation allowance for deferred tax assets | (22,560,000)  | (19,903,000)  |

|                         |      |      |
|-------------------------|------|------|
| Net deferred tax assets | \$ - | \$ - |
|-------------------------|------|------|

Realization of our deferred tax assets, which relate to operating loss carry-forwards and timing differences, is dependent on future earnings, among other factors. The timing and amount of future earnings are uncertain and therefore a valuation allowance has been established. The increase in the valuation allowance on the deferred tax asset during the year ended July 31, 2012 was \$2,657,000.

F-19

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A reconciliation of income taxes computed using the statutory income tax rate, compared to the effective tax rate, is as follows:

|  | 2012  |   | 2011  |   |
|--|-------|---|-------|---|
| Federal tax benefit at the expected statutory rate | 34.0  | % | 34.0  | % |
| State income tax, net of federal tax benefit       | 5.8   |   | 5.8   |   |
| Other  | (9.9  | ) | (3.5  | ) |
| Valuation allowance                                | (29.9 | ) | (36.3 | ) |
| Income tax benefit - effective rate                | 0.0   | % | 0.0   | % |

Following authoritative guidance, we recognize the tax benefit from a tax position if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position.

Our practice is to recognize interest and/or penalties related to income tax matters in income tax expense; however we have had no accrued interest or penalties at either July 31, 2012 or July 31, 2011. We are subject to income taxes in the United States and in California, and our historical tax years remain subject to future examination by the U.S. and California tax authorities. During the year ended July 31, 2012, we did not record any activity related to our unrecognized tax benefits.

The Company and its subsidiaries are subject to federal income tax as well as income tax of multiple state jurisdictions. With few exceptions, the Company is no longer subject to income tax examination by tax authorities in major jurisdictions for years prior to 2007. However, to the extent allowed by law, the taxing authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the carryforwards. The Company is not currently under examination by the IRS or state taxing authorities.

## 12. Subsequent Events

### Reverse Stock Split

On August 13, 2012, we filed a Certificate of Amendment to our Certificate of Incorporation with the Secretary of State of the State of Delaware to effect a reverse stock split of our issued and outstanding common stock, \$0.01 par value per share, at a ratio of one-for-eight. The reverse stock split was approved by stockholders holding a majority of our outstanding voting power at our annual meeting of stockholders held on July 31, 2012. The reverse stock split became effective as of the close of trading on August 14, 2012 and commenced trading on a post-reverse split basis as of the opening of trading on August 15, 2012, with each eight (8) issued and outstanding shares of our common stock automatically combined and converted into one (1) issued and outstanding share of our common stock. The reverse stock split affected all issued and outstanding shares of our common stock, as well as common stock underlying stock options, warrants, and convertible notes outstanding immediately prior to the effectiveness of the reverse stock split, but did not affect the number of authorized shares of our common stock. As a result of the reverse stock split, the number of outstanding shares of our common stock was reduced from approximately 57.8 million immediately prior to the effectiveness of the reverse stock split to approximately 7.2 million immediately thereafter.

### NASDAQ Delisting

As previously disclosed in certain of our reports filed with the SEC, commencing in September 2011, we have received a series of deficiency letters from the NASDAQ Stock Market, or NASDAQ, and have undergone a lengthy appeal process with a NASDAQ Hearings Panel, or the Panel, relating to the potential delisting of our common stock from the NASDAQ Capital Market for noncompliance with several listing rules and standards. After receiving several letters from the Panel granting our continued listing contingent upon our satisfaction of certain specified conditions, on September 21, 2012, we received a final decision letter notifying us that the NASDAQ Listing Qualifications Staff

had concluded that we had satisfied the required conditions and regained compliance with all applicable listing requirements, and accordingly had determined to continue the listing of our securities on the NASDAQ Capital Market and to close the matter of our delisting on that date.

On October 1, 2012, we received a new deficiency letter from NASDAQ regarding our noncompliance with NASDAQ's audit committee membership requirements as a result of the death of our former director and Audit Committee member Gregory Barnhill. Consistent with applicable NASDAQ listing rules, NASDAQ has granted us the following cure period to regain compliance with NASDAQ's audit committee membership requirements: (i) until the earlier of our next annual meeting of stockholders or September 14, 2013, or (ii) if our next annual meeting of stockholders is held before March 13, 2013, until March 13, 2013. We intend to appoint an independent director who satisfies NASDAQ's requirements for membership on our Audit Committee as promptly as practicable to rectify this noncompliance.

F-20

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**Common Stock Financing — Underwritten Public Offering**

On September 17, 2012, we closed an underwritten public offering of an aggregate of 4,341,615 shares of our common stock, including shares issued pursuant to the exercise of the underwriter's overallotment option, at a price to the public of \$1.10 per share for net proceeds to us of approximately \$4,313,000 (after deducting underwriting discounts and commissions and other offering expenses, although before payment of certain other legal and accounting expenses). The offering was made pursuant to our registration statement on Form S-3 (Registration No. 333-182475), which became effective on July 31, 2012, and a preliminary and final prospectus supplement filed with the Securities Exchange Commission on September 4, 2012 and September 13, 2012, respectively. The shares were sold pursuant to an underwriting agreement between us and Aegis Capital Corp., which was previously filed as an exhibit to our Current Report on Form 8-K filed on September 13, 2012. We intend to use the net proceeds from the offering for working capital and general corporate purposes. We also used the net proceeds from the offering to pay the full amount of the indebtedness we incurred in connection with the Bridge Loan, described in further detail under Note 4 above.

