

PURE BIOSCIENCE, INC.  
Form 10-Q  
June 13, 2011  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

---

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED APRIL 30, 2011

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

Commission File Number 0-21019

---

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

---

Delaware  
(State or other jurisdiction of incorporation or  
organization)

33-0530289  
(I.R.S. Employer Identification No.)

1725 Gillespie Way  
El Cajon, California  
(Address of principal executive offices)

92020  
(Zip Code)

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

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 ☐

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the 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 ☐ Smaller reporting company ☒

Edgar Filing: PURE BIOSCIENCE, INC. - Form 10-Q

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

As of June 10, 2011, there were 39,749,216 shares of the registrant's common stock, \$0.01 par value per share, outstanding.

---

PURE Bioscience, Inc.

FORM 10-Q

for the Quarterly Period Ended April 30, 2011

TABLE OF CONTENTS

PART 1 — FINANCIAL INFORMATION

- 1. 

Item Consolidated Financial Statements:

Consolidated Balance Sheets as of April 30, 2011 (unaudited) and July 31, 2010

Consolidated Statements of Operations for the three and nine months ended April 30, 2011 and 2010 (unaudited)

Consolidated Statements of Cash Flows for the nine months ended April 30, 2011 and 2010 (unaudited)

Notes to Consolidated Financial Statements (unaudited)
- 2. 

Item Management's Discussion and Analysis of Financial Condition and Results of Operations
- 3. 

Item Quantitative and Qualitative Disclosures about Market Risk
- 4. 

Item Controls and Procedures

PART II — OTHER INFORMATION

- 1. 

Item Legal Proceedings
- 1A. 

Item Risk Factors
- 4. 

Item (Removed and Reserved)
- 6. 

Item Exhibits

SIGNATURES



PURE Bioscience, Inc.

## CONSOLIDATED BALANCE SHEETS

	(Unaudited) April 30, 2011	July 31, 2010
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$309,637	\$2,192,543
Accounts receivable, net of allowance for doubtful accounts of \$353,004 at April 30, 2011 and \$0 at July 31, 2010	97,684	332,493
Inventories, net	913,687	752,438
Prepaid expenses	189,700	146,307
<b>Total current assets</b>	<b>1,510,708</b>	<b>3,423,781</b>
Property, plant and equipment, net	494,936	696,974
Patents	1,921,115	1,872,882
<b>Total assets</b>	<b>\$3,926,759</b>	<b>\$5,993,637</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$916,887	\$329,281
Accrued liabilities	213,640	241,498
Deferred revenue	-	10,000
Taxes payable	-	2,400
<b>Total current liabilities</b>	<b>1,130,527</b>	<b>583,179</b>
Deferred Rent	8,972	16,045
<b>Total liabilities</b>	<b>1,139,499</b>	<b>599,224</b>
<b>Stockholders' Equity</b>		
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 37,296,986 issued and outstanding at April 30, 2011, and 35,488,317 issued and outstanding at July 31, 2010	372,970	354,883
Additional paid-in capital	51,353,761	47,365,389
<b>Warrants:</b>		
1,509,100 issued and outstanding at April 30, 2011, and 1,889,663 issued and outstanding at July 31, 2010	2,639,315	2,934,600
Accumulated deficit	(51,578,786 )	(45,260,459 )
<b>Total stockholders' equity</b>	<b>2,787,260</b>	<b>5,394,413</b>

Total liabilities and stockholders' equity	\$3,926,759	\$5,993,637
--	-------------	-------------

The accompanying notes are an integral part of the consolidated financial statements

## PURE Bioscience, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

	For the Nine Months Ended April 30,		For the Three Months Ended April 30,	
	2011	2010	2011	2010
<b>REVENUES FROM PRODUCT SALES</b>				
Net revenues	\$209,903	\$1,112,343	\$128,417	\$563,491
Cost of sales	61,985	414,843	36,915	221,811
Gross profit	147,918	697,500	91,502	341,680
<b>OTHER REVENUES</b>				
Revenue from license agreements	10,000	-	-	-
Cost of other revenue	-	-	-	-
Gross profit	10,000	-	-	-
Total gross profit	157,918	697,500	91,502	341,680
Selling expenses	885,373	731,117	247,345	284,341
General and administrative expenses	3,961,986	3,783,973	1,190,208	1,179,090
Research and development	1,647,417	1,412,140	472,537	502,447
Total operating expenses	6,494,776	5,927,230	1,910,090	1,965,878
Loss from operations	(6,336,858 )	(5,229,730 )	(1,818,588 )	(1,624,198 )
Other income				
Interest income	6,131	26,797	816	8,623
Other	12,500	115,608	-	5,608
Total other income	18,631	142,405	816	14,231
Net loss before income taxes	(6,318,227 )	(5,087,325 )	(1,817,772 )	(1,609,967 )
Income tax provision	(100 )	-	-	-
Net loss	\$(6,318,327 )	\$(5,087,325 )	\$(1,817,772 )	\$(1,609,967 )
Net loss per common share, basic and diluted	\$(0.17 )	\$(0.15 )	\$(0.05 )	\$(0.05 )
Weighted average common shares used in computing basic and diluted net loss per common share	36,662,054	34,282,084	37,276,199	34,882,442

The accompanying notes are an integral part of the consolidated financial statements





## PURE Bioscience, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	For the Nine Months Ended April 31,	
	2011	2010
Cash flows from operating activities		
Net loss	\$(6,318,327 )	\$(5,087,325 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization and depreciation	351,724	349,733
Stock-based compensation	807,418	949,243
Allowance for doubtful accounts	353,004	-
Changes in assets and liabilities:		
Accounts receivable	(118,195 )	(237,142 )
Prepaid expense	(43,393 )	(108,240 )
Inventories	(161,249 )	(75,645 )
Deferred rent	(7,073 )	(1,753 )
Deferred revenue	(10,000 )	-
Customer deposits	-	9,400
Accounts payable and accrued liabilities	559,748	177,414
Income tax payable	(2,400 )	(2,400 )
Net cash used in operating activities	(4,588,743 )	(4,026,715 )
Cash flows from investing activities		
Investment in patents	(186,738 )	(88,049 )
Purchase of property, plant and equipment	(11,181 )	(221,313 )
Net cash used in investing activities	(197,919 )	(309,362 )
Cash flows from financing activities		
Net proceeds from the sale of common stock	2,367,089	2,783,233
Proceeds from exercise of stock options and warrants	536,667	623,204
Net cash provided by financing activities	2,903,756	3,406,437
Net decrease in cash and cash equivalents	(1,882,906 )	(929,640 )
Cash and cash equivalents at beginning of period	2,192,543	4,213,744

Edgar Filing: PURE BIOSCIENCE, INC. - Form 10-Q

Cash and cash equivalents at end of period	\$ 309,637	\$ 3,284,104
Supplemental disclosures of cash flow information		
Cash paid for taxes	\$ 2,400	\$ 2,400

The accompanying notes are an integral part of the consolidated financial statements

Notes to Consolidated Financial Statements (Unaudited)

Note 1. Basis of Presentation

PURE Bioscience, Inc. (sometimes referred to herein as the “Company”, “we”, “us”, or “our”) was originally incorporated in the state of California on August 24, 1992 under the name PURE Bioscience. The accompanying unaudited financial statements include the consolidated accounts of PURE Bioscience, Inc. and its subsidiary, ETIH2O Corporation, a Nevada corporation. All inter-company balances and transactions have been eliminated.

On March 24, 2011, Pure Bioscience, a California corporation ("Pure California"), consummated a merger with and into its wholly owned subsidiary, Pure Bioscience, Inc., a Delaware corporation (the "Company"), pursuant to which we reincorporated as a Delaware corporation (the “Reincorporation”). As a result of the Reincorporation, Pure California has ceased to exist and the Company, as the surviving corporation of the merger, continues to operate the business of Pure California as it existed prior to the Reincorporation. In addition, as a result of the Reincorporation, the Company's authorized capital stock consists of 100,000,000 shares of common stock, \$0.01 par value per share, and 5,000,000 shares of preferred stock, \$0.01 par value per share. 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, the Reincorporation did not result in any change in the business, physical location, management, assets, liabilities or net worth of the Company, 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. Such reclassification had no effect on the results of operations or the total amount of stockholders' equity.

The financial statements included herein have been prepared by PURE Bioscience, Inc. without audit, in accordance with the instructions to Securities and Exchange Commission (“SEC”) Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”), have been condensed or omitted as allowed by such rules and regulations, however we believe that the accompanying unaudited financial statements contain all adjustments (including normal recurring adjustments) necessary to present fairly the financial condition, results of operations and cash flows for the periods presented. The unaudited consolidated financial statements presented herein should be read in conjunction with our audited financial statements for our most recently completed fiscal year ended July 31, 2010 (“Fiscal 2010”) and their accompanying notes, as filed with the SEC in our 10-K on October 28, 2010.

The preparation of our consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in the statements and accompanying notes, and actual results could differ materially from those estimates. The results of operations for the three month period ended April 30, 2011 (the “Third Quarter”), and for the nine month period ended April 30, 2011 (the “Nine Months”) are not necessarily indicative of the results of operations for the full year, or any future periods.

Note 2. Nature of Business and Summary of Significant Accounting Policies

Concentration of Credit Risk

We have not experienced any losses in our cash and cash equivalents and believe we are not exposed to any significant credit risk. At times, deposits held may exceed the federally insured limits. Generally, these deposits may be redeemed upon demand and, therefore, are believed to bear low risk.

Other financial instruments that potentially subject us to concentrations of credit risk consist of accounts receivable. We extend credit to certain of our U.S. domestic customers based on credit evaluations and past payment performance, but do not obtain collateral to secure our accounts receivable.

### Fair Value of Financial Instruments

The carrying amounts for receivables and payables are the approximate fair value because of their short maturity. Whenever shares are issued for services, we use market prices of our common stock to estimate the fair value of the shares issued. Whenever options are issued for services, we use the Black-Scholes Option Pricing Model to estimate the fair value of the equity instrument, using historical market prices of our common stock and prevailing risk-free interest rates.

### Revenue Recognition

During the periods presented herein, our product revenue was derived from the sale of silver dihydrogen citrate (“SDC”) concentrate, our ready to use disinfectant, and finished packaged products containing SDC. We recognize revenue from sales of these products under the provisions of the applicable authoritative guidance governing revenue recognition, which is generally when we ship the products free on board from either our facility or from third party packagers, we have transferred title to the goods, the price is fixed or determinable and we have eliminated our risk of loss. Where payment is not reasonably assured at the time of shipment, we will either decline a purchase order or defer the revenue until payment is assured. In the three months ended October 31, 2010 (the “First Quarter”), we recorded deferred revenue of \$344,900 for a transaction where payment was not reasonably assured at the time of shipment of the product, as discussed further in Note 3 below.

Any amounts received prior to satisfying our revenue recognition criteria are recorded as deferred revenue in our consolidated balance sheets. We recorded deferred revenue of \$10,000 at July 31, 2010 related to an amount that we received from FTA Bioscience, LLC (“FTA”), our development partner for SDC-based products for human use, in connection with a request for us to issue a license for a new indication. Subsequent to our review of pre-clinical data submitted by FTA, we issued a license to FTA and recognized the \$10,000 payment as revenue from license agreements in the three months ended January 31, 2011 (the “Second Quarter”).

### Cost of Goods Sold

Cost of goods sold for product sales includes direct and indirect costs to manufacture products, including materials consumed, manufacturing overheads, 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.

## Intangible Assets / Long-Lived Assets

Our intangible assets primarily consist of the worldwide patent portfolio of our silver ion technologies. Outside legal costs and filing fees related to obtaining patents are capitalized as incurred. The total amounts capitalized for pending patents were \$45,300 and \$19,900 in the Third Quarter and the three month period ended April 30, 2010, respectively, and \$186,700 and \$88,000 in the nine month periods ended April 30, 2011 and 2010, respectively. Patents are stated net of accumulated amortization of \$1,569,200 and \$1,430,700 at April 30, 2011 and July 31, 2010, respectively. The cumulative cost of acquiring patents is amortized on a straight-line basis over the estimated remaining useful lives of the patents, generally between 17 and 20 years from the date of issuance. At April 30, 2011, the weighted average remaining amortization period for all patents was approximately 10.0 years. Amortization expense for the Third Quarter and the three month period ended April 30, 2010 was \$47,100 and \$44,800, respectively, and for the nine month periods ended April 30, 2011 and 2010 was \$138,500 and \$133,600, respectively.

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, equipment and finite-lived intangible assets primarily consisting of the worldwide patent portfolio of our silver ion technologies, 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.

## Accounting for Stock-Based Compensation

We utilize the fair value method of accounting for stock-based compensation arrangements. Accordingly, the compensation cost of share-based awards issued in connection with employee and director services is measured at the grant date based on the estimated fair value of the award, and is recognized as expense over the applicable service

period. We do not have, and have not had during the nine month periods ended April 30, 2011 or 2010, any stock option awards with market or performance conditions.

#### Stock Options to Non-Employees

Charges for stock options granted to non-employees have been determined using the estimated fair value of the stock options issued, based on the Black-Scholes Option Pricing Model. Such options are revalued quarterly until fully vested, with any change in fair value expensed. During the Third Quarter, we recorded \$6,300 in selling expense, and recorded a reduction in research and development expense of \$5,000; and during the three month period ended April 30, 2010, we recorded \$63,100 in selling expense, \$23,600 in general and administrative expense, and \$25,600 in research and development expense for stock options granted to non-employees. During the Nine Months, we recorded \$40,700 in selling expense, and recorded a reduction in both general and administrative expense and research and development expense of \$4,500 and \$7,800, respectively. During the nine month period ended April 30, 2010, we recorded \$74,100 in selling expense, \$27,800 in general and administrative expense, and \$33,300 in research and development expense for stock options granted to non-employees.

#### Cash, Cash Equivalents, Short-term Investments and Liquidity

We consider all liquid investments with maturities of ninety days or less when purchased to be cash equivalents.

On September 3, 2009, we closed a registered direct offering whereby we sold \$3 million of our common stock and warrants to institutional investors. After fees and expenses, the aggregate net proceeds of the offering to us were approximately \$2.8 million.

On October 25, 2010, we consummated a financing whereby we entered into common stock purchase agreements with a total of eleven non-affiliated accredited investors for the sale of 1,080,000 shares of our common stock at a price of \$2.20 per share, for a total purchase price of \$2.376 million. We did not engage any underwriter or placement agent to assist with the financing, and therefore no underwriter discounts or commissions were paid. The shares sold in the financing represented approximately 3% of our outstanding common stock prior to the sale. We relied on an exemption from registration under Regulation D and Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"). No advertising or general solicitation was employed in offering the shares, which were offered solely to a limited number of non-affiliated accredited investors (as defined in Rule 501(a) of the Securities Act) and transfer of the shares is restricted by the Company in accordance with the requirements of the Securities Act. After expenses, the net proceeds of the financing to us were \$2.367 million, to be used for working capital.

On April 29, 2011, we entered into a Sales Agreement with C. K. Cooper & Company (“CKCC”), an investment banking firm, under which we may issue and sell shares of our common stock for consideration of up to \$7.0 million, from time to time in an at the market equity offering program (the “ATM Program”), with CKCC acting as our agent. As of June 10, 2011, we have sold 2,391,030, shares of our Common Stock for net proceeds of \$2,908,000 pursuant to the ATM Program. Continued sales of our common stock, if any, under the ATM Program will depend upon market conditions and other factors to be determined by us and may be made in negotiated transactions or transactions that are deemed to be “at the market offerings” as defined in Rule 415 under the Securities Act. While future sales of our common stock are not guaranteed, and there are no firm commitments to receive funding under the ATM Program, based on net proceeds received through the date of this report and the historical trading volumes and market prices of our common stock, we believe we will have sufficient cash resources over the next 12 months as a result of the ATM Program. During the Third Quarter, we incurred \$98,200 of fees associated with the ATM Program. These deferred equity financing costs are included in prepaid expenses on our consolidated balance sheets and will be offset against net proceeds from future sales of common stock. No sales of common stock were made in our ATM Program during the Nine Months. See Note 9 for information regarding sales of common stock subsequent to April 30, 2011.

We believe that, with our current efforts to raise capital through our ATM Program, we will have 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.

We expect that we will need to increase our liquidity and capital resources by one or more measures, which may include reducing operating expenses, raising additional financing in future periods through the issuance of debt, equity (whether through our ATM Program or otherwise), 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 would 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, 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. Such modification of our business model and operations could also result in an impairment of assets, which cannot be determined at this time. Furthermore, if we issue equity or convertible debt securities to raise additional funds, our existing stockholders may experience dilution, and in addition 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.

The financial statements do not include any adjustments relating to recoverability or classification of recorded assets and classification of recorded liabilities.

#### Comprehensive Loss

Comprehensive loss is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources, including foreign currency translation adjustments and unrealized gains and losses on marketable securities. Our components of comprehensive loss consist only of net loss.

For the Third Quarter and the three month period ended April 30, 2010, our comprehensive loss was \$1,817,800 and \$1,610,000, respectively. For the Nine Months and the nine month period ended April 30, 2010, our comprehensive loss was \$6,318,300 and \$5,087,300, respectively.

#### Net Loss Per Common Share

We compute basic loss per share by dividing the applicable net loss by the weighted average number of common shares outstanding during the respective period. Diluted per share amounts assume the conversion, exercise or issuance of all potential common stock equivalents, which include stock options, common stock warrants and unvested restricted stock, unless the effect is to reduce a loss or increase the income per common share from continuing operations. As we incurred losses in each of the three and nine month periods ended April 30, 2011 and 2010, we did not include common stock equivalent shares in the computation of net loss per share as the effect would have been anti-dilutive. Therefore, both the basic and diluted loss per common share for the three and nine month periods ended April 30, 2011 and 2010 are based on the weighted average number of shares of our common stock outstanding during these periods. As of April 30, 2011, anti-dilutive instruments excluded from the computation of net loss per share were made up of 2,425,300 stock options, 1,509,100 warrants, and 101,100 shares of unvested restricted stock; a total of 4,035,500 potential common stock equivalents.

#### Recent Accounting Pronouncements

In June 2009, the FASB issued authoritative guidance for the consolidation of variable interest entities, to require an issuer to perform an analysis to determine whether the issuer's variable interest or interests give it a controlling financial interest in a variable interest entity, if any. This analysis identifies the primary beneficiary of a variable interest entity as one with the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and the obligation to absorb losses of the entity that could potentially be significant to the variable interest. The guidance became effective for us on August 1, 2010, however it did not have a material impact on our consolidated financial statements.

In October 2009, the FASB issued authoritative guidance that amends existing revenue recognition accounting pronouncements related to multiple-deliverable revenue arrangements. The new guidance provides accounting principles and application guidance on whether multiple deliverables exist, how the arrangement should be separated, and how the consideration should be allocated. This guidance eliminates the requirement to establish the fair value of undelivered products and services and instead provides for separate revenue recognition based upon management's estimate of the selling price for an undelivered item when there is no other means to determine the fair value of that undelivered item. The guidance became effective for us on August 1, 2010, however it did not have a material impact on our consolidated financial statements.



In January 2010, the FASB issued authoritative guidance that requires new disclosures and clarifies certain existing disclosure requirements about fair value measurements. The new guidance requires a reporting entity to disclose significant transfers in and out of Level 1 and Level 2 fair value measurements, to describe the reasons for the transfers and to present separately information about purchases, sales, issuances and settlements for fair value measurements using significant unobservable inputs. We adopted the guidance in the third quarter of Fiscal 2010, except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements, which became effective, and we adopted, during the Third Quarter. The adoption of the guidance did not have a material impact on our consolidated financial statements.

In April 2010, the FASB issued guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. The guidance became effective for us on a prospective basis for milestones achieved beginning with the First Quarter; however it did not have a material impact on our consolidated financial statements. We will continue to evaluate this guidance, however we do not expect it to have a material impact on our consolidated financial statements for future periods.

### Note 3. Accounts Receivable

Trade accounts receivable are recorded net of allowances for doubtful accounts. Estimates for allowances for doubtful accounts are determined based on payment history and individual customer circumstances. The allowance for doubtful accounts was \$353,000 at April 30, 2011 and zero at July 31, 2010.

The Company and Richmond Sciences, LLC ("Richmont") entered into an Alliance Agreement effective as of October 6, 2009 ("the "Alliance Agreement"). In the First Quarter, we shipped product to Richmont and billed \$359,600, however, collection was not reasonably assured at the time of shipment and we recognized the amount billed, less our costs associated with the shipment, of \$344,900 as deferred revenue on our consolidated balance sheets at October 31, 2010. As of January 31, 2011, \$335,800 of the \$359,600 remained uncollected and was included in accounts receivable in our consolidated balance sheets at that date. The \$23,800 collected to date was recognized as product revenue in the Second Quarter, and the remaining balance of deferred revenue, net of our costs associated with the uncollected balance of the shipment, as reported on our consolidated balance sheets at January 31, 2011, was \$322,100. We have not collected any additional amounts related to the deferred revenue reported on our consolidated balance sheets at January 31, 2011.

Subsequent to January 31, 2011, deferred revenue of \$322,100 and accounts receivable of \$335,800 remained on our balance sheet from the Richmont order recorded in the First Quarter described above. In addition to deferred revenue, we also had \$17,200 of receivables related to other Richmont orders. On April 25, 2011, we communicated to Richmont our intent to terminate our relationship with Richmont for breach, and we currently expect our agreement with Richmont to terminate in late June 2011. Due to the expected termination of our relationship with Richmont, there is substantial doubt as to the collectability of these receivables; therefore, in the Third Quarter, we established a full reserve of approximately \$353,000 for the outstanding receivables owed to us by Richmont, and removed the remaining deferred revenue from our consolidated balance sheets. Management currently considers all other accounts receivable to be fully collectible.

### Note 4. Sales of Common Stock

On September 3, 2009, we closed a registered direct offering whereby we sold \$3 million of our common stock and warrants to institutional investors. After fees and expenses, the aggregate net proceeds of the offering to us were approximately \$2.8 million.

On October 25, 2010 we consummated a financing whereby we entered into common stock purchase agreements with a total of eleven non-affiliated accredited investors for the sale of 1,080,000 shares of our common stock at a price of

\$2.20 per share, for a total purchase price of \$2.376 million. We did not engage any underwriter or placement agent to assist with the financing, and therefore no underwriter discounts or commissions were paid. The shares sold in the financing represented approximately 3% of our outstanding common stock prior to the sale. We relied on an exemption from registration under Regulation D and Section 4(2) of the Securities Act. No advertising or general solicitation was employed in offering the shares, which were offered solely to a limited number of non-affiliated accredited investors (as defined in Rule 501(a) of the Securities Act) and transfer of the shares is restricted by the Company in accordance with the requirements of the Securities Act. After expenses, the net proceeds of the offering to us were \$2.367 million, to be used for working capital.

On April 29, 2011, we entered into a Sales Agreement with CKCC, under which we may issue and sell shares of our common stock for consideration of up to \$7.0 million, from time to time in an at the market equity offering program (the "ATM Program"), with CKCC acting as our agent. As of June 10, 2011, we have sold 2,391,030 shares of our Common Stock for net proceeds of \$2,908,000 pursuant to the ATM Program. Continued sales of our common stock, if any, under the ATM Program will depend upon market conditions and other factors to be determined by us and may be made in negotiated transactions or transactions that are deemed to be "at the market offerings" as defined in Rule 415 under the Securities Act. We are not obligated to sell any shares of our Common Stock in the ATM Program and may suspend or terminate the ATM Program at any time. During the Third Quarter, we incurred \$98,200 of fees associated with the ATM Program. These deferred equity financing costs are included in prepaid expenses on our consolidated balance sheets and will be offset against net proceeds from future sales of common stock. No sales of common stock were made in our ATM Program during the Nine Months. See Note 9 for information regarding sales of common stock subsequent to April 30, 2011.

#### Note 5. Other Equity and Common Stock Transactions

We paid no dividends during any of the periods presented, and have never paid dividends.

During the First Quarter, we issued options to purchase up to 75,000 shares of our common stock in exchange for business development services, at an exercise price of \$2.43, valued at \$104,100 (based on the Black-Scholes Option Pricing Model assuming no dividend yield, volatility of 90.70% and a risk-free interest rate of 0.54%). Two-thirds of the options vest in annual increments over two years with one third vesting on the date of grant. Additionally during the First Quarter, we issued options to purchase up to 25,000 shares of our common stock in exchange for intellectual property management services, at an exercise price of \$2.43, valued at \$33,900 (based on the Black-Scholes Option Pricing Model assuming no dividend yield, volatility of 89.90% and a risk-free interest rate of 0.52%). The options vest in bi-annual increments over one year. Each award will be revalued quarterly until fully vested, with any change in fair value expensed.

Also during the First Quarter, we received \$259,100 from the exercise of warrants to purchase 123,365 shares of our common stock, at an average exercise price \$2.10; received \$20,000 from the exercise of options to purchase 25,000 shares of our common stock issued under employee stock option plans; and received an aggregate of \$106,000 from the exercise of options to purchase 200,000 shares of our common stock by two of our directors. In addition, we recorded \$264,900 of expense for options issued to employees, officers, directors, and consultants.

During the Second Quarter, we granted an aggregate of 39,900 shares of restricted stock to three of our directors, and a ten year option to purchase up to 20,000 shares of common stock at an exercise price of \$2.13 per share, to one of our directors. Both the restricted stock and the options granted to our directors vest after one year. The 39,900 shares of restricted stock were valued at \$82,200, or \$2.06 per share (based on the prevailing market price of our common stock on the date of grant), while the stock options were valued at \$28,900 (based on the Black-Scholes Option Pricing Model assuming no dividend yield, volatility of 81.15%, and a risk free interest rate of 2.14%). Both the restricted stock and stock options will be expensed over the vesting period of one year, and were issued pursuant to the 2002 Non-Qualified Stock Option Plan.

Also during the Second Quarter, we received \$32,000 from the exercise of employee stock options to purchase 40,000 shares of our common stock; received an aggregate of \$37,100 from the exercise of options to purchase 70,000 shares of our common stock by two of our directors; and recorded \$248,200 of expense for options issued to employees, officers, directors, and consultants. In addition, during the Second Quarter, our company secretary and two of our directors elected to net exercise an aggregate of 290,000 options, which resulted in the issuance of 220,304 shares of our common stock. As these stock options were net exercised, as permitted under the applicable option plans, we did not receive any cash.

During the Third Quarter, we received \$82,500 from the exercise of options to purchase 50,000 shares of our common stock by one of our directors. In addition, we recorded \$202,500 of expense for options issued to employees, officers, directors, and consultants.

At April 30, 2011, we had outstanding warrants to purchase 1,509,100 shares of our common stock, with exercise prices ranging from \$2.06 to \$8.60. These warrants expire at various times between October 2012 and March 2015.

#### Note 6. Stock-Based Compensation

We have the following active equity incentive plans (the “Plans”) pursuant to which options to acquire common stock or restricted stock awards have been granted and are currently outstanding: the 2002 Non-Qualified Stock Option Plan; the 2002 Employee Incentive Stock Option Plan; the 2004 Consultants and Advisors Stock Option Plan; and the 2007 Equity Incentive Plan. The Plans are administered by the Compensation Committee of the Board of Directors (the “Compensation Committee”), except that the full Board of Directors makes decisions regarding equity grants to our executive officers, although officers who are also members of our Board do not vote on matters related to their own compensation or equity awards. The exercise price for stock options, or the value of other incentive grants granted under the Plans, are set by the Compensation Committee or Board of Directors but may not be for less than the fair

market value of the shares on the date the award is granted. The term of option grants and their vesting provisions are set by the Compensation Committee or Board of Directors.

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 are defined pursuant to the terms of the consulting agreement. Share-based compensation expense for awards granted subsequent to July 31, 2006 is based on the grant date fair value estimated using the Black-Scholes Option Pricing Model. The following assumptions were used to calculate the fair value of share based compensation for the nine month periods ended April 30, 2011 and 2010:

	For the nine month periods ended April 30,	
	2011	2010
Expected price volatility	81.15% - 82.22%	99.8% - 158.1%
Risk-free interest rate	1.70% - 2.14%	0.42% - 2.20%
Expected rate of forfeiture	0.0%	0.0%
Expected dividend yield	0.0%	0.0%
Weighted average expected term	4.74 years	2.98 years

Expected price volatility is the measure by which our stock price is expected to fluctuate during the expected term of an option. Expected 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. For stock options granted subsequent to July 31, 2006, we have excluded the period prior to November 1, 2005 from our historical price volatility, as during this period our market price reflected significant uncertainty associated with both our arbitration proceedings against Falken Industries and our ability to close the sale of the assets of the Water Treatment Division. We believe that the volatility of the market price of our common stock during periods prior to November 1, 2005 is not reflective of future expected volatility.

Following the guidance of Staff Accounting Bulletin No. 107 (“SAB 107”), we have been following the “Simplified Method” to determine the expected term of “Plain Vanilla” options issued to employees and directors. All of our outstanding options granted to employees and directors are Plain Vanilla options. 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. In SAB 107, the Staff stated that it would not expect a company to use the Simplified Method for share option grants after December 31, 2007, however on December 21, 2007 the SEC published Staff Accounting Bulletin No. 110 (“SAB 110”), which expressed the views of the Staff regarding the continued use of the Simplified Method in certain circumstances where a company is unable to rely on historical data. We are unable to rely on our historical exercise data as there have been only a limited number of option exercises in recent periods; our common stock was traded until April 2008 on the illiquid Bulletin Board but our common stock is now listed on the NASDAQ Capital Market; we have had over recent years significant trading blackout periods for employees and directors; there has been minimal employee and director turnover; we have periodically changed the terms of employee stock option grants to amend the standard term of such grants; there are no comparable companies in terms of size, location and industry (particularly as we are developing a platform technology and operate in multiple industries); and we have had significant structural changes in our business including the sale of the Water Treatment Division and abandonment of our Triglycylboride technology, and expect to continue to change in the foreseeable future. We are therefore, under the guidance of SAB 110, continuing to use the Simplified Method to determine the expected term of options issued to employees and directors, but will continually evaluate our historical data as a basis for determining the expected terms of such options.

Our estimation of the expected term for stock options granted to parties other than employees or directors is the contractual term of the option award. For the purposes of estimating the fair value of stock option awards, the risk-free interest rate used in the Black-Scholes calculation is based on the prevailing U.S. Treasury yield as determined by the U.S. Federal Reserve. We have never paid any dividends on our common stock and do not anticipate paying dividends on our common stock in the foreseeable future.

Stock-based compensation expense recognized in our consolidated statements of operations is based on awards ultimately expected to vest, reduced for estimated forfeitures. Authoritative guidance requires forfeitures to be estimated at the time of grant, and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Historically, we have not had significant forfeitures of stock options granted to employees and directors. A significant number of our historical stock option grants were fully vested at issuance or were issued with short vesting provisions. Therefore, we have estimated the forfeiture rate of our outstanding stock options as zero, but will continually evaluate our historical data as a basis for determining expected forfeitures.

The following table sets forth the share-based compensation expense recorded in our consolidated statements of operations for the three and nine month periods ended April 30, 2011 and 2010 resulting from share-based compensation awarded to our employees, directors and third party service providers:

	Three Months Ended April 30, 2011	Three Months Ended April 30, 2010
Share-based compensation for employees and directors:		
Selling expense	\$29,400	\$12,300
General and administrative expenses	154,600	153,000
Research and development	17,200	15,400
Total share-based compensation for employees and directors	201,200	180,700
Share-based compensation for third party service providers:		
Selling expense	\$6,300	\$63,100

Edgar Filing: PURE BIOSCIENCE, INC. - Form 10-Q

General and administrative expenses	-	23,600
Research and development	(5,000 )	25,600
Total share-based compensation for third party service providers	1,300	112,300
Total share-based compensation expense	\$202,500	\$293,000

	Nine Months Ended April 30, 2011	Nine Months Ended April 30, 2010
Share-based compensation for employees and directors:		
Selling expense	\$89,300	\$44,300
General and administrative expenses	597,700	697,400
Research and development	92,000	55,700
Total share-based compensation for employees and directors	779,000	797,400
Share-based compensation for third party service providers:		
Selling expense	\$40,700	\$74,100
General and administrative expenses	(4,500 )	44,400
Research and development	(7,800 )	33,300
Total share-based compensation for third party service providers	28,400	151,800
Total share-based compensation expense	\$807,400	\$949,200

A summary of stock option activity is as follows:

	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value (\$000's)
Balance at July 31, 2010	5,736,050	\$ 2.12	\$4,628
Granted	110,000	\$ 2.38	
Exercised	(225,000 )	\$ 0.56	
Forfeited / Cancelled	(39,500 )	\$ 4.17	
Balance at October 31, 2010	5,581,550	\$ 2.17	\$3,391
Granted	20,000	\$ 2.13	
Exercised	(400,000 )	\$ 0.56	
Forfeited / Cancelled	(566,300 )	\$ 1.33	
Balance at January 31, 2011	4,635,250	\$ 2.41	\$913
Granted	-	-	
Exercised	(50,000 )	\$ 1.65	
Forfeited / Cancelled	(2,160,000 )	\$ 1.73	
Balance at April 30, 2011	2,425,250	\$ 3.04	

Range of Exercise Prices	Number of Shares Outstanding	Outstanding Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number of Shares Exercisable	Exercisable Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
\$1.45 to \$2.50	1,202,050	3.29	\$2.06	543,626	2.80	\$1.93
\$3.00 to \$5.75	1,223,200	4.87	\$4.00	675,000	1.47	\$4.59
	2,425,250	4.09	\$3.04	1,218,626	2.07	\$3.41

Cash received from options and warrants exercised in the Third Quarter and the three month period ended April 30, 2010 was \$82,500 and \$538,200, respectively. The intrinsic value of all stock options exercised during the Third Quarter and the three month period ended April 30, 2010 was \$15,500 and \$114,000, respectively, and the weighted-average grant date fair value of stock options granted during the Third Quarter and the three month period ended April 30, 2010 was zero and \$2.60, respectively.

Cash received from options and warrants exercised in the nine month periods ended April 30, 2011 and 2010 was \$536,700 and \$623,200, respectively. The intrinsic value of all stock options exercised during the nine month periods ended April 30, 2011 and 2010 was \$1,089,400 and \$726,000, respectively, and the weighted-average grant date fair value of stock options granted during the nine month periods ended April 30, 2011 and 2010 was \$0.84 and \$1.45, respectively.

As of April 30, 2011, there was \$2,072,800 of unrecognized non-cash compensation cost related to unvested options, which will be recognized over a weighted average period of 2.44 years.

A summary of restricted stock activity is as follows:

	Number of Shares
Unvested at July 31, 2010	61,200
Granted	-
Exercised	-
Forfeited / Cancelled	-
Unvested at October 31, 2010	61,200
Granted	39,900
Exercised	-
Forfeited / Cancelled	-
Unvested at January 31, 2011	101,100
Granted	-
Exercised	-
Forfeited / Cancelled	-
Unvested at April 30, 2011	101,100



During the Third Quarter and the three month period ended April 30, 2010, we recognized stock based compensation expense for restricted stock of \$61,800 and \$38,100, respectively. During the nine month periods ended April 30, 2011 and 2010, we recognized stock based compensation expense for restricted stock of \$153,700 and \$103,700, respectively. As of April 30, 2011, there was \$67,600 of unrecognized non-cash compensation cost related to unvested restricted shares, which will be recognized over a period of 0.30 years.

#### Note 7. Inventory

Inventories are stated at the lower of cost or net realizable value using the average cost method. Inventories at April 30, 2011 and July 31, 2010 consisted of:

	April 30, 2011	July 31, 2010
Raw Materials	\$ 553,500	\$ 448,300
Work in Progress	-	-
Finished Goods	360,200	304,100
	\$ 913,700	\$ 752,400

Included in our inventory of finished goods as of July 31, 2010 was approximately 3,700 gallons of SDC concentrate out of 12,000 gallons that we purchased in prior periods from an unrelated third party in a lien sale, for \$27,500. None of the product purchased in the lien sale remained in inventory at April 30, 2011.

#### Note 8. Business Segment and Sales Concentrations

Operating segments are defined as components for which separate financial information is available and evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. We believe that based upon the end use of our products, the value added contributions made by us, the regulatory requirements, our customers and partners, and the strategy required to successfully market finished products, we are operating in a single segment.

In Fiscal 2010 we commenced selling our EPA-approved hard surface disinfectant under the label, IV-7 Ultimate Germ Defense™ (“IV-7”) through an alliance with a Dallas-based sales and marketing organization, Richmond Sciences, LLC (“Richmont”), to U.S. commercial distributors and commercial customers. Under this agreement with Richmont, we recognized revenues for products sold by us to third parties, and paid marketing fees to Richmont based upon those revenues. We recognized revenue from the first sales of IV-7 under this agreement in Fiscal 2010.

Also in Fiscal 2010, IV-7 was launched direct to consumers via a direct sales channel, by a newly formed company called IV-7 Direct, an affiliate of Richmont. PURE Bioscience, Inc. does not have an equity interest in either IV-7 Direct or Richmont. Under this arrangement, we sold finished products at contracted unit prices to Richmont, and we also expected to receive additional revenues based on IV-7 Direct’s sales, which were made through a network of independent sales associates using a multi-level sales model.

In October 2010, Richmont established distribution of SDC-based products in the Middle East region. Richmont initially purchased IV-7 products for resale into Dubai, where the IV-7 water treatment and disinfection products have been registered by the United Arab Emirates-Dubai Municipality. Richmont focused first on distribution of IV-7 Water Treatment™. We made the first shipments of IV-7 Water Treatment™, a concentrated product, during the First Quarter, and recorded deferred revenue of \$344,900 because payment was not reasonably assured at the time of shipment of the product, as discussed further in Note 3 above.

During the Third Quarter, 75% of product sales were made to three customers; 66% of product revenue was derived from sales made to U.S. domestic customers and 34% from sales made to international customers. We categorize

revenue between U.S. domestic and international based on the country of domicile of our customer.

During the Third Quarter, 11% of our revenue was derived from bulk ready to use disinfectant or finished packaged products containing our ready to use disinfectant, and 89% of our product sales were of SDC concentrate. During the same period of the prior fiscal year, 57% of our product sales were of bulk ready to use disinfectant or finished packaged products containing our ready to use disinfectant, and 43% of our product sales were of SDC concentrate.

During the Nine Months, 58% of product sales were made to three customers; 79% of product revenue for the Nine Months was derived from sales made to U.S. domestic customers and 21% from sales made to international customers. 31% of our product revenue was derived from bulk ready to use disinfectant or finished packaged products containing our ready to use disinfectant, and 69% of our product sales were of SDC concentrate. Our deferred revenue as reported on our consolidated balance sheets at April 30, 2011 was derived from concentrate sales.

During the same period of the prior fiscal year, 58% of our product sales were of bulk ready to use disinfectant or finished packaged products containing our ready to use disinfectant, and 42% of our product sales were of SDC concentrate.

All of our tangible assets are located in the United States.

#### Note 9. Subsequent Events

Subsequent to the Third Quarter, we received \$3,045,100 from the sale of 2,391,030 shares of our common stock at a weighted average price of \$1.27 per share under our sales agreement with CKCC as discussed further in Note 4. Our net proceeds were \$2,908,000 after paying commissions and fees to CKCC totaling \$137,100.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This report contains forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “potential” or “continue,” the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we, nor any other person, assume responsibility for the accuracy and completeness of the forward-looking statements. We are under no obligation to update any of the forward-looking statements after the filing of this Quarterly Report on Form 10-Q to conform such statements to actual results or to changes in our expectations.

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes and other financial information appearing elsewhere in this Quarterly Report. Readers are also urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the factors which affect our business, including without limitation the disclosures made in Item 1A of Part II of this Quarterly Report under the Caption “Risk Factors” and in our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended July 31, 2010 (“Fiscal 2010”), previously filed with the Securities and Exchange Commission (“SEC”).

Risk factors that could cause actual results to differ from those contained in the forward-looking statements include but are not limited to: our limited operating history; our ability to achieve or maintain profitability; our history of losses; our future capital needs; the dilution our stockholders may experience as a result of the issuance of our equity securities; the failure of our products to achieve or maintain broad acceptance; our ability to manage growth; the rapidly changing technologies and market demands related to our products; our failure to successfully compete; our dependence on a single core technology; our reliance on third parties; our lack of product distribution experience; fluctuations in our financial results; our exposure to pricing and supply issues; our failure to comply with government regulation; our recent appointment of a new Chief Financial Officer; our ability to recruit additional key employees; our failure to protect our intellectual property; our exposure to intellectual property and product liability claims; changes in government policies; adverse changes in our ability to manufacture our products; volatility in the trading price of our common stock; our failure to maintain our NASDAQ listing; our inability to utilize our tax net operating loss carry-forwards; our failure to pay dividends and other risks identified in Part II, Item 1A of this Quarterly Report on Form 10-Q.

The financial statements presented herein, and discussed below, have been prepared in accordance with U.S. Generally Accepted Accounting Principles.

### Overview

PURE Bioscience, Inc. (sometimes referred to herein as the “Company,” “we,” “us” or “our”) was originally incorporated in the state of California on August 24, 1992 under the name Innovative Medical Services. In September 2003, we changed our name from Innovative Medical Services to PURE Bioscience. On March 24, 2011, Pure Bioscience, a California corporation (“Pure California”), consummated a merger with and into its wholly owned subsidiary, Pure Bioscience, Inc., a Delaware corporation (the “Company”), pursuant to the terms and conditions of an Agreement and Plan of Merger entered into by Pure California and the Company, thereby effecting our reincorporation in the State of Delaware (the “Reincorporation”). Following the Reincorporation, Pure California ceased to exist and the Company, as the surviving corporation of the merger, continues to operate the business of Pure California as it existed prior to the Reincorporation.

We began as a provider of pharmaceutical water purification products for the pharmacy market; however we divested all assets associated with this business in the sale, in May 2005, of our Water Treatment Division. In 2000, we commenced investments in the development of novel bioscience technologies, and subsequent to May 2005 we have been exclusively focused on the development and commercialization of our current and future bioscience products.

We are expanding into markets that we believe have broad potential by developing new, proprietary bioscience products based upon our patented silver ion antimicrobial technologies. We are developing technology-based products, including our silver dihydrogen citrate-based antimicrobials, which we believe can provide novel, non-toxic solutions to numerous global health challenges and represent innovative advances in diverse markets. We believe that our technologies are in a position to contribute significantly to today's global trend toward industrial and consumer use of environmentally friendly products, while providing competitive advantages in efficacy and safety.

On April 29, 2011, we entered into a Sales Agreement with C. K. Cooper & Company ("CKCC"), an investment banking firm, under which we may issue and sell shares of our common stock for consideration of up to \$7.0 million, from time to time in an at the market equity offering program (the "ATM Program"), with CKCC acting as our agent. As of June 10, 2011, we have sold 2,391,030 shares of our Common Stock for net proceeds of \$2,908,000 pursuant to the ATM Program. Continued sales of our common stock, if any, under the ATM Program will depend upon market conditions and other factors to be determined by us and may be made in negotiated transactions or transactions that are deemed to be "at the market offerings" as defined in Rule 415 under the Securities Act. While future sales of our common stock are not guaranteed, and there are no firm commitments to receive funding under the ATM Program, based on net proceeds received through the date of this report and the historical trading volumes and market prices of our common stock, we believe we will have sufficient cash resources over the next 12 months as a result of the ATM Program.

We believe that, with our current efforts to raise capital, we will have 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.

We expect that we will need to increase our liquidity and capital resources by one or more measures, which may include reducing operating expenses, raising additional financing in future periods through the issuance of debt, equity (whether through our ATM Program or otherwise), 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 would 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, 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. Such modification of our business model and operations could also result in an impairment of assets which cannot be determined at this time. Furthermore, if we issue equity or convertible debt securities to raise additional funds, our existing stockholders may experience dilution, and in addition the new equity or debt securities may have rights, preferences and privileges senior 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.

#### Bioscience Technologies

Our flagship bioscience technology is a patented, aqueous antimicrobial called silver dihydrogen citrate (“SDC”). A novel molecular entity, SDC is an electrolytically generated source of stabilized ionic silver that can serve as the basis for a broad range of products in diverse markets. SDC liquid is colorless, odorless, tasteless, non-caustic and formulates well with other compounds. We believe that our SDC-based antimicrobial is distinguished from competitors in the marketplace because of its superior efficacy combined with reduced toxicity. We are producing pre-formulated, ready-to-use products for both our own brands and for private label distribution, as well as varying strengths of SDC concentrate as an additive or raw material for inclusion in other companies’ products. We are also producing SDC as an Active Pharmaceutical Ingredient (“API”), currently in clinical trials for multiple indications. In addition to SDC, we have obtained patent protection for ionic silver-based molecular entities utilizing 14 organic acids other than citric acid.

#### Sources of Revenue

Our principal sources of revenue are comprised of sales of SDC concentrate as well as both bulk and individually bottled SDC-based hard surface disinfectants and disinfectant/food contact surface sanitizers. We sell SDC in a variety of concentrations and formulations to certain partners and distributors who in turn (i) resell the concentrate as an active ingredient or preservative in other companies’ products; (ii) blend the product into hard surface disinfectant products for sale to retail, commercial and institutional customers; and/or (iii) develop novel formulations under a license granted by us. In addition, we sell both bulk and individually bottled hard surface disinfectant products, both directly and through distributors, to retail, commercial and institutional customers. Our sales to date have been limited, and SDC products have not yet been widely accepted into the marketplace, and may never be accepted.

In prior years, customers purchasing our U.S. Environmental Protection Agency (“EPA”) registered disinfectants were primarily distributors who sell such products under their own labels as a sub-registrant of our EPA master label, however in Fiscal 2010 we commenced selling our EPA-registered hard surface disinfectant under the label, IV-7 Ultimate Germ Defense™ (“IV-7”) through an agreement with a Dallas-based sales and marketing organization, Richmond Sciences, LLC (“Richmont”), to U.S. and international commercial customers and distributors. We recognized revenue from the first sales of IV-7 under this agreement during the three month period ended January 31, 2010.

In the second quarter of calendar 2010, IV-7 was launched direct to consumers via a direct sales channel, by a newly formed company called IV-7 Direct, an affiliate of Richmond. We do not have an equity interest in either IV-7 Direct or Richmond. Under this arrangement, we sold finished products at contracted unit prices to Richmond, and we also expected to receive additional revenues based on IV-7 Direct's sales, which were made through a network of independent sales associates using a multi-level sales model. We recognized revenue from the first sales of IV-7 under this agreement in Fiscal 2010.

In August 2009, as a result of our 6-year petition process, the EPA published an amendment to the Federal Register establishing a concentration limit for silver in end use solutions eligible for tolerance exemption, specifically in the form of silver dihydrogen citrate (SDC), of 50 parts per million ("ppm"). Concurrently with the new regulation, the EPA registered our 50 ppm indirect food contact surface sanitizer product. We subsequently submitted a registration to the EPA to add the food contact surface sanitizer claims to our previously-registered 30 ppm hard surface disinfectant formula. The EPA registered the disinfectant/sanitizer formula in April 2010, and we immediately filed a federal sub-registration and subsequent state registrations for the disinfectant/sanitizer product to be sold as IV-7 Ultimate Germ Defense for Food Contact Surfaces™. The final state approval was received in November 2010, and Richmond was expected to commence sales and marketing of IV-7 Ultimate Germ Defense for Food Contact Surfaces™ throughout the U.S.

In October 2010, Richmond established distribution of SDC-based products in the Middle East region. Richmond initially purchased IV-7 products from us for resale in the United States and in the Middle East, where the IV-7 Water Treatment™ and disinfectant products have been registered with the United Arab Emirates-Dubai Municipality. Richmond initially focused on distribution of IV-7 Water Treatment™, a concentrated product. In December 2010, we announced that High Scope Trading LLC ("High Scope") of Dubai had contractually committed to Richmond more than \$144 million in orders for SDC-based products over a ten year period in exchange for exclusive distribution of such products in the Middle East. However, similar to other agreements that we or Richmond have with other parties we are working with to establish our novel technology, these minimums are not guaranteed and the remedy for High Scope's failure to perform is limited to their loss of exclusivity, meaning that some or all of High Scope's contractual commitments may not be met and investors should not assume any of these payments will be received. We made the first shipments of IV-7 Water Treatment™ to Richmond during the three month period ended October 31, 2010 (the "First Quarter"), and recorded deferred revenue of \$344,900 on our consolidated balance sheets at October 31, 2010, as collection was not reasonably assured at the time of shipment. During the three month period ended January 31, 2011 (the "Second Quarter"), we collected \$23,800 of the amount owed and recorded that amount as product revenue. The remaining balance of deferred revenue, as reported on our consolidated balance sheets at January 31, 2011, was \$322,100.

On April 25, 2011, we communicated to Richmond our intent to terminate our relationship with Richmond for breach, and we currently expect our agreement with Richmond to terminate in late June 2011. We have not collected any additional amounts related to the deferred revenue reported on our consolidated balance sheets at January 31, 2011.

Subsequent to January 31, 2011, deferred revenue of \$322,100 and accounts receivable of \$335,800 remained on our consolidated balance sheets from the Richmond order recorded in the First Quarter. In addition to deferred revenue, we also had \$17,200 of receivables related to other Richmond orders. Due to the expected termination of our relationship with Richmond, there is substantial doubt as to the collectability of these receivables; therefore, in the Third Quarter, we established a full reserve of approximately \$353,000 owed to us by Richmond, and removed the remaining deferred revenue from our consolidated balance sheets.

During Fiscal 2010 and in prior years, we sold SDC concentrate to BASF under an agreement whereby BASF resold the concentrate under its own brand names within the global personal care, household and institutional markets. We have terminated our agreement with BASF and are currently selling directly to BASF customers while evaluating alternatives for distribution in these markets. We believe we can secure better positioning for SDC with companies that do not carry proprietary competing products.

In July 2008, we entered into a development and licensing agreement for SDC-based products for human use with FTA Bioscience, LLC ("FTA"). Under our agreement with FTA, FTA is funding and directing all development activities and FDA regulatory filings. In July 2010, based on preclinical data developed by FTA, we granted two product-specific licenses to FTA for the development of an SDC-based treatment for tinea unguium, also referred to as onychomycosis (nail fungus), as well as for tinea pedis (athlete's foot); and concurrently recognized the first milestone payments under this agreement with FTA. In the Second Quarter, we recognized a milestone payment when we granted a third product-specific license to FTA for the development of an SDC-based treatment for wound care.

In preparation for the expected termination of our relationship with Richmond, we developed and obtained EPA registration of our proprietary new brand, PURE™ Hard Surface disinfectant and food contact surface sanitizer to resume direct control of our sales through a restructuring of our sales strategy and operations. We intend to market and sell our PURE Hard Surface product into consumer, commercial and institutional markets, including the food processing industry, through both alternative and traditional distribution channels. In April 2011, we launched the PURE Hard Surface product and have commenced sales. We are also currently in negotiation with several entities regarding international distribution of our SDC-based disinfectant and water treatment products.

Revenue from all sources is recognized under the provisions of the applicable authoritative guidance governing revenue recognition, which is generally when we ship the products free on board from either our facility or from third party packagers, we have transferred title to the goods, the price is fixed or determinable and we have eliminated our risk of loss. Where payment is not reasonably assured at the time of shipment, we will either decline a purchase order or defer the revenue until payment is assured. When the title of the goods, including the risks and rewards of ownership of the product, transfers to the customer, i.e. when we ship the product, we reduce the balance of our inventory with a corresponding charge to cost of goods sold. Additionally, we evaluate the substance of each transaction and consider whether the facts and circumstances indicate the transaction is a consignment or financing arrangement. Specifically, we do not offer the right of return; our customers are obligated to pay at specified dates; the obligation of our customers cannot be changed due to theft or physical destruction of the product; our customers are separate entities with economic substance apart from the Company; and we have no significant obligations for future performance to directly bring about resale of the product by our customer.

Under our agreement with Richmond, Richmond functioned as a sales agent for PURE. We sold product directly to third parties, and paid Richmond a commission based on revenue collected from the third parties. In addition to our sales agent agreement, in Fiscal 2010, IV-7 was launched direct to consumers via a direct sales channel, by a newly

formed company called IV-7 Direct, an affiliate of Richmond. Under that arrangement, we sold finished products at contracted unit prices to Richmond. We record revenue when products are sold to our customers, including, but not limited to, Richmond Sciences, LLC, IV-7 Direct, and BASF, rather than when the products are resold to third parties. We do not currently have any consignment sales.

Our revenues have historically fluctuated from period to period. In future periods, we expect our revenues to continue to fluctuate, however we are not currently able to accurately predict such revenues. Product sales are uncertain, and may be dependent on approvals from U.S. or overseas regulatory agencies, which we may not obtain.

#### Costs of Revenues and Operating Expenses

**Costs of Revenue.** Costs of product revenue includes direct and indirect costs to manufacture products, including materials consumed, manufacturing overheads, shipping costs, salaries, benefits, and related expenses of our operations; and, during Fiscal 2010, costs incurred to have products bottled and labeled by a third party. In addition, included in our inventory of finished goods as of July 31, 2010 were approximately 3,700 gallons of SDC concentrate that we purchased from an unrelated third party in a lien sale. None of the product purchased in the lien sale remained in inventory at April 30, 2011 (see Note 7 to our consolidated financial statements for further information regarding this transaction).

Gross profit on product sales represents net revenue less the costs of revenue. Our gross profit percentage is highly dependent on pricing, contractual agreements, product mix, customer mix, and other factors. We do not believe that historical gross profit margins on product sales are a reliable indicator of future gross profit margins.

**Selling and Marketing.** Selling and marketing expenses consist primarily of salaries and benefits, and amounts paid to third party providers for marketing, sales, public relations and advertising, along with promotional and trade show costs and travel expenses. Sales and marketing expenses also include share-based compensation allocable to employees and third party advisors performing services related to sales and marketing. Under our agreement with Richmond, we have paid marketing fees to Richmond and recorded such fees as selling expense in our consolidated statements of operations. We expect our agreement with Richmond to terminate in late June 2011.



**General and Administrative.** General and administrative expenses include employee salaries and benefits, and amounts paid to third party providers for finance and accounting, legal, human resources, insurance, information technology, and other administrative activities. General and administrative expenses also include share-based compensation allocable to employees and third party advisors performing general and administrative services.

**Research and Development.** Research and development costs include in-house research costs, expenditures for third party testing, patent amortization, outside legal costs for maintaining issued patents, and product registration expenditures. We do not currently expect our research and development expense to grow significantly in future periods, however if opportunities arise, particularly in the development and testing of new formulations, we will evaluate the need for additional research expenditures based on potential market sizes and our estimation of the likelihood of our technology achieving successful results. Research and development expenses also include share-based compensation allocable to employees and third party advisors performing services related to research and development.

### Critical Accounting Policies

#### Accounting for Long-Lived Assets / Intangible Assets

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, equipment and finite-lived intangible assets primarily consisting of the worldwide patent portfolio of our silver ion technologies, 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.

## Accounting for Stock-Based Compensation

Stock-based compensation expense for all stock-based compensation awards granted after August 1, 2006 is based on the grant date fair value estimated in accordance with the provisions of applicable authoritative guidance. Specifically, we estimate the weighted-average fair value of options granted using the Black-Scholes Option Pricing Model based on evaluation assumptions regarding expected volatility, dividend yield, risk-free interest rates, the expected term of the option and the expected forfeiture rate. Each of these assumptions, while reasonable, requires a certain degree of judgment and the fair value estimates could vary if the actual results are materially different than those initially applied.

Prior to August 1, 2006, we were not required to record compensation cost in our consolidated financial statements for stock options issued to employees or directors. Subsequently, the estimated grant date fair value of such awards is expensed over the applicable service period of the award, which is generally the vesting period. We do not have any stock option awards with market or performance conditions.

The fair value of stock options granted to non-employees is expensed over the applicable service period. Such options are revalued quarterly until fully vested.

## Results of Operations for the Three Months Ended April 30, 2011 vs. Three Months Ended April 30, 2010

### Revenue and Gross Margin

For the Third Quarter, product revenues of \$128,400 declined by \$435,100, compared with product revenues of \$563,500 in the same period of the prior fiscal year.

Our most significant customers in the prior fiscal year were Harmony Bioscience, our Asian distributor, and BASF. Harmony Bioscience has not yet ordered product in the year ending July 31, 2011 while they await regulatory approvals. During Fiscal 2010 and in prior years, we sold SDC concentrate to BASF under an agreement whereby BASF resold the concentrate under its own brand names within the global personal care, household and institutional markets. We have terminated our agreement with BASF and are currently selling directly to BASF customers while evaluating alternatives for distribution in these markets. We believe we can secure better positioning for SDC with companies that do not carry proprietary competing products.

In prior years, customers purchasing our EPA-registered disinfectants were primarily distributors who sell such products under their own labels as a sub-registrant of our EPA master label. In Fiscal 2010, we commenced selling our EPA-registered hard surface disinfectant under the label, IV-7 Ultimate Germ Defense™ (“IV-7”) through our agreement with Richmond to U.S. commercial distributors and commercial customers. In November 2010, we commenced selling our EPA-registered disinfectant/food contact surface sanitizer under the label, IV-7 Ultimate Germ Defense for Food Contact Surfaces™ (“IV-7 Food Contact”), through our arrangement with Richmond. Under this agreement with Richmond, we recognized revenues for products sold by us to third parties, and paid marketing fees to Richmond based upon those revenues. Richmond’s sales to date of IV-7 and IV-7 Food Contact to commercial distributors and commercial customers have been limited.

Also in Fiscal 2010, IV-7 was launched direct to consumers via a direct sales channel, by a newly formed company called IV-7 Direct, an affiliate of Richmond. We do not have an equity interest in either IV-7 Direct or Richmond. Under this arrangement, we sold finished products at contracted unit prices to Richmond, and we also expected to receive additional revenues based on IV-7 Direct’s sales, which were made through a network of independent sales associates using a multi-level sales model. Sales to date via the direct sales channel have been limited.

In October 2010, Richmond established distribution of SDC-based products in the Middle East region. Richmond initially purchased IV-7 products from us for resale into the Middle East, where the IV-7 Water Treatment™ and disinfection products have been registered by the United Arab Emirates-Dubai Municipality. Richmond initially focused on distribution of IV-7 Water Treatment™. In December 2010, we announced that High Scope had contractually committed to Richmond more than \$144 million in orders for SDC-based products over a ten year period in exchange for exclusive distribution in the Middle East. However, similar to agreements that we or Richmond have with other parties we are working with to establish our novel technology, these minimums are not guaranteed and the remedy for High Scope’s failure to perform is limited to their loss of exclusivity, meaning that some or all of High Scope’s contractual commitments may not be met and investors should not assume any of these payments will be received. We made the first shipments of IV-7 Water Treatment™ to Richmond during the First Quarter, and recorded deferred revenue of \$344,900 on our consolidated balance sheets at October 31, 2010, as collection was not reasonably assured at the time of shipment. In the Second Quarter, we collected \$23,800 of the amount owed and recorded that amount as product revenue.

On April 25, 2011, we communicated to Richmond our intent to terminate our relationship with Richmond for breach, and we currently expect our agreement with Richmond to terminate in late June 2011. We have not collected any additional amounts related to the deferred revenue reported on our consolidated balance sheets at January 31, 2011.

Subsequent to January 31, 2011, deferred revenue of \$322,100 and accounts receivable of \$335,800 remained on our consolidated balances sheet from the Richmond order recorded in the First Quarter. In addition to deferred revenue, we also had \$17,200 of receivables related to other Richmond orders. Due to our expected termination of the Richmond relationship, we believe there is substantial doubt as to the collectability of these receivables. In the Third Quarter, we established a full reserve of \$353,000 owed to us by Richmond, and removed the remaining deferred revenue from our consolidated balance sheets.

During the Third Quarter, 75% of product sales were made to three customers; 66% of our product revenue was derived from sales made to U.S. domestic customers and 34% from sales made to international customers. We categorize revenue between U.S. domestic and international based on the country of domicile of our customer. Our deferred revenue as reported on our consolidated balance sheets at April 30, 2011 was derived from concentrate sales.

During the three month period ended April 30, 2010, 75% of product sales were made to four customers, and 100% of product revenue was derived from sales made to U.S. domestic customers, of which 57% was derived from sales of bulk ready to use disinfectant or finished packaged products containing our ready to use disinfectant, and 43% of our

sales were of bulk SDC concentrate or concentrated products.

Primarily as a result of the mix of products sold and prices, our gross margin percentage improved from 61% in the three months ended April 30, 2010, to 71% in the Third Quarter. Due to the limited volume of sales in each period, historical margins should not be used as a predictor of future margins. Gross profit on product sales for the Third Quarter was \$91,500, compared with comparable gross profit of \$341,700 in the same period of the prior fiscal year.

We received \$10,000 in Fiscal 2010 from FTA in connection with a request for us to issue a license for a new indication. Subsequent to our review of pre-clinical data submitted by FTA, we issued a license to FTA and recognized the \$10,000 payment as revenue from license agreements in our consolidated statements of operations for the Second Quarter. There were no revenues from license agreements in the Third Quarter.

#### Operating Costs

Operating costs decreased by \$55,800, or 2.8%, from \$1,965,900 in the three month period ended April 30, 2010, to \$1,910,090 in the Third Quarter.

Selling expense decreased by \$37,000, or 13%, in the Third Quarter compared with the same period in the prior fiscal year. The decrease is primarily due to a reduction in non-cash stock option expense for business development consultants, as well as reductions in public relations expense. These reductions were partially offset by increased trade show exhibition costs, and consulting expense.

General and administrative expense increased by \$11,100, or 0.9%, from \$1,179,100 in the three month period ended April 30, 2010, to \$1,190,200 in the Third Quarter. The increase is primarily due to bad debt expense incurred as a result of the expected uncollectibility of the Richmond receivables, as well as increased insurance and legal expense. These increases were partially offset by reductions in payroll and non-cash stock option expense.

Research and development costs during the Third Quarter of \$472,500, which include in-house costs, patent amortization, outside legal costs for maintaining issued patents, and product registration expenditures, decreased by \$29,900, or 6.0%, compared with the comparable prior fiscal year period. This decrease is primarily due to a reduction in non-cash stock option expense and consulting expense. These reductions were partially offset by increased patent and registration expense. We do not currently expect our research and development expense to grow significantly in future periods; however, if opportunities arise, particularly in the development and testing of new formulations, we will evaluate the need for additional research expenditures based on potential market sizes and our estimation of the likelihood of our technology achieving successful results.

Our loss from operations increased by \$194,390 from a loss of \$1,624,200 for the three months ended April 31, 2010 to a loss of \$1,818,600 for the Third Quarter.

#### Other Income

Other income in the Third Quarter declined year over year by \$13,400, due mainly to a reduction in interest income as a result of low cash balances.

#### Net Loss

Our net loss increased by \$207,800, from a net loss of \$1,610,000, or \$0.05 per share, for the three months ended April 30, 2010 to a net loss of \$1,817,800, or \$0.05 per share, for the Third Quarter.

#### Results of Operations for the Nine Months Ended April 30, 2011 vs. Nine Months Ended April 30, 2010

##### Revenue and Gross Margin

For the nine month period ended April 30, 2011 (the "Nine Months"), product revenues of \$209,900 declined by \$902,400 compared with comparable revenues of \$1,112,300 in the same period of the prior year.

During the Nine Months, 58% of our product sales were made to three customers; 79% of our product revenue was derived from sales made to U.S. domestic customers and 21% from sales made to international customers. Also during the Nine Months, 31% of our product revenue was derived from bulk ready to use disinfectant or finished packaged products containing our ready to use disinfectant, and 69% of our product sales were of SDC concentrate.

In the same period of the prior fiscal year, 69% of product sales were made to five customers. 80% of product revenue was derived from sales made to U.S. domestic customers and 20% was derived from sales to our Asian distributor. Also in the same period of the prior fiscal year, 58% of sales were of bulk ready to use disinfectant or finished packaged products containing our ready to use disinfectant, and 42% of our sales were of bulk SDC concentrate or concentrated products.

Primarily as a result of the mix of products sold and prices, our gross margin percentage for product sales improved from 63% in the nine months ended April 30, 2010, to 71% in the Nine Months. Due to the limited volume of sales in each period, historical margins should not be used as a predictor of future margins. Gross profit on product sales for the Nine Months was \$147,900, compared with gross profit on product sales of \$697,500 in the same period of the prior fiscal year.

We received \$10,000 in Fiscal 2010 from FTA in connection with a request for us to issue a license for a new indication. Subsequent to our review of pre-clinical data submitted by FTA, we issued a license to FTA and recognized the \$10,000 payment as revenue from license agreements in our consolidated statements of operations for the Nine Months. There were no revenues from license agreements in the corresponding periods of the prior year.

## Operating Costs

Operating costs increased by \$567,600, or 9.6%, from \$5,927,200 in the nine month period ended April 30, 2010, to \$6,494,800 in the Nine Months. Within these aggregate operating costs, selling expense increased by \$154,300 in the Nine Months compared with the same period in the prior fiscal year, primarily due to fees and non-cash stock option expense for business development consultants, trade show exhibition costs, and executive bonuses allocated to selling expense.

General and administrative expense increased by \$178,000, from \$3,784,000 in the nine month period ended April 30, 2010, to \$3,962,000 in the Nine Months, primarily due to increased payroll, legal fees, executive bonuses allocated to general and administrative expense, and travel expenses; partially offset by reduced non-cash stock option expense.

Research and development costs during the Nine Months of \$1,647,400, including in-house costs, patent amortization, outside legal costs for maintaining issued patents, and product registration expenditures, increased by \$235,300, or 16.7%, compared with the comparable prior year period. This increase is primarily due to increased salary and related costs, product registration costs, and executive bonuses allocated to research and development expense. We do not currently expect our research and development expense to grow significantly in future periods; however, if opportunities arise, particularly in the development and testing of new formulations, we will evaluate the need for additional research expenditures based on potential market sizes and our estimation of the likelihood of our technology achieving successful results.

Our loss from operations increased by \$1,107,200, from a loss of \$5,229,700 for the nine months ended April 30, 2010 to a loss of \$6,336,900 for the Nine Months.

## Other Income

Other income declined year over year by \$123,800, due mainly to the receipt in the three month period ended January 31, 2010 of \$110,000 from a legal settlement.

## Net Loss

Our net loss after income taxes increased by \$1,231,000, from a net loss of \$5,087,300, or \$0.15 per share, for the nine months ended April 30, 2010 to a net loss of \$6,318,300, or \$0.17 per share, for the Nine Months.

## Liquidity and Capital Resources

Since the sale of our Water Treatment Division in 2005, we have financed our operations primarily through sales of our common stock.

At April 30, 2011, we had cash and cash equivalents of \$309,600, a decline of \$1,882,900 from July 31, 2010. Net cash used in operations, and for investments in both intangible and fixed assets, was \$4,786,700 in the Nine Months and \$4,336,100 in Fiscal 2010. At April 30, 2011, we had no short-term investments and no long-term debt. Total current assets at April 30, 2011 were \$1,510,700, a decline of \$1,913,100 from July 31, 2010.

We believe that, with our current efforts to raise capital, we will have 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.

Our future capital needs and our future profits, if any, are uncertain, and will depend on many factors including, among others, the acceptance of, and demand for, our products; our success and the success of our partners and distributors 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, and developing new, products or technologies; the extent to which we invest in new technology and product development; and the costs associated with the continued operation, and any future growth, of our business. We expect that we will need to increase our liquidity and capital resources by one or more measures, which may include reducing operating expenses, raising additional financing in future periods 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 would 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, 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. Such modification of our business model and operations could also result in an impairment of assets which cannot be determined at this time. Furthermore, if we issue equity or convertible debt securities to raise additional funds, our existing stockholders may experience dilution, and in addition the new equity or debt securities may have rights, preferences and privileges senior 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. The financial statements contained herein do not include any adjustments relating to recoverability or classification of recorded assets and classification of recorded liabilities.

Cash used in operating activities for the Nine Months was \$4,588,700, as compared to \$4,026,700 used in operating activities for the same nine month period of the prior fiscal year.

During the Nine Months, cash used in investing activities was \$197,900, consisting primarily of investments in patents. At April 30, 2011, the net book value of our capitalized patents was \$1,921,100, and the net book value of our property, plant and equipment was \$494,900. In the nine month period ended April 30, 2010, cash used in investing activities was \$309,400, consisting of investments in patents of \$88,000 and purchases of property, plant and equipment of \$221,300.

During the Nine Months, cash provided by financing activities was \$2,903,800. On October 25, 2010, we consummated a financing whereby we entered into common stock purchase agreements with a total of eleven non-affiliated accredited investors for the sale of 1,080,000 shares of our common stock at a price of \$2.20 per share, for a total purchase price of \$2.376 million. We did not pay any placement agent fees associated with the financing and no underwriter discounts or commissions were paid. After legal and other expenses, the net proceeds of the financing to us were \$2.367 million. On April 29, 2011, we entered into a Sales Agreement with C. K. Cooper & Company (“CKCC”), an investment banking firm, under which we may issue and sell shares of our common stock for consideration of up to \$7.0 million, from time to time in an at the market equity offering program (the “ATM Program”), with CKCC acting as our agent. As of June 10, 2011, we have sold 2,391,030 shares of our Common Stock for net proceeds of \$2,908,000 pursuant to the ATM Program. Continued sales of our common stock, if any, under the ATM Program will depend upon market conditions and other factors to be determined by us and may be made in negotiated transactions or transactions that are deemed to be “at the market offerings” as defined in Rule 415 under the Securities Act of 1933. While future sales of our common stock are not guaranteed, and there are no firm commitments to receive funding under the program, based on net proceeds received through the date of this report and the historical trading volumes and market prices of our common stock, we believe we will have sufficient cash resources over the next 12 months as a result of our ATM Program. During the Third Quarter, we incurred \$98,200 of fees associated with the offering. These deferred equity financing costs will be offset against net proceeds from future sales of common stock. No sales of common stock were made under this agreement during the Nine Months.

Also during the Nine Months, we received \$259,100 from the exercise of warrants to purchase 123,365 shares of our common stock, at an average exercise price of \$2.10 per share, and we received \$277,600 from the exercise of 385,000 common stock options, at an average exercise price of \$0.72 per share.

During the nine months ended April 30, 2010, cash provided by financing activities was \$3,406,400, \$2,783,200 of which was derived from the net proceeds of our September 2009 registered direct offering. In addition, \$498,200 was provided by proceeds from the exercise of warrants, and \$125,000 was provided by proceeds from the exercise of common stock options.



Net accounts receivable declined by \$234,800 from July 31, 2010 to April 30, 2011. During the Third Quarter, we recorded an allowance for doubtful accounts of \$353,000 related to deferred revenue and amounts billed in prior periods to Richmond Sciences, LLC.

At April 30, 2011, we had total liabilities of \$1,139,500, an increase of \$540,300 from July 31, 2010. Accounts payable and accrued liabilities also increased from July 31, 2010, by \$559,700, due primarily to the timing of accounts payable and accrued salaries and wages.

#### Off Balance Sheet Arrangements

We do not have any off balance sheet arrangements.

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our exposure to interest rate risk at April 30, 2011 is related to our investment portfolio which consists largely of debt instruments and other securities of high quality corporate issuers and the U.S. government and its agencies. From time to time our investments may be exposed to market risk related to changes in interest rates. Our current investment policy is to maintain an investment portfolio consisting only of diversified institutional money market mutual funds investing in A-1 (S&P) or Prime-1 (Moody's), U.S. Treasury Securities, or United States Government obligations issued by or backed by a federal agency of the United States Government. We do not enter into investments for trading or speculative purposes, and our cash is deposited in, and invested through, highly rated financial institutions in the United States. While our available for sale securities are subject to interest rate risk and would fall in value if market interest rates increased, we estimate that the fair value of our investment portfolio would not decline by a material amount in the event of an increase in market interest rates. We therefore would not expect our operating results or cash flows to be affected to any significant degree by the effect of a change in market interest rates on our investments.

We have operated mainly in the United States, and the majority of our sales since inception have been made in U.S. dollars. Further, all of our sales to international markets have been to independent parties in transactions denominated in U.S. dollars. Accordingly, we have not had any material exposure to foreign currency rate fluctuations.

#### Item 4. 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, who is also serving as our Interim Chief Financial Officer and Principal Accounting 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 and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) under the Exchange Act, we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer, who is also serving as our Interim Chief Financial Officer and Principal Accounting 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 report. Based on the foregoing evaluation, our Chief Executive Officer, in his capacities as our principal executive officer and our principal financial officer, concluded that as of the end of the period covered by this report our disclosure controls and procedures were effective.

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.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. However, litigation 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 that we believe will have, individually or in the aggregate, a material adverse effect on our business, financial condition or operating results.

### Item 1A. Risk Factors

Except for the historical information contained herein or incorporated by reference, this quarterly report on Form 10-Q and the information incorporated by reference contains forward-looking statements that involve risks and uncertainties. These statements include projections about our accounting and finances, plans and objectives for the future, future operating and economic performance and other statements regarding future performance. These statements are not guarantees of future performance or events. Our actual results may differ materially from those discussed here. Factors that could cause or contribute to differences in our actual results include those discussed in the following section, as well as those discussed in Part I, Item 2 entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere throughout this quarterly report on Form 10-Q and in any other documents incorporated by reference into this report. You should consider carefully the following risk factors, together with all of the other information included or incorporated in this quarterly report on Form 10-Q. Each of these risk factors, either alone or taken together, could adversely affect our business, operating results and financial condition, as well as adversely affect the value of an investment in our common stock. 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. If any of the events described below were to occur, our financial condition, our ability to access capital resources, our results of operations and/or our future growth prospects could be materially and adversely affected and the market price of our common stock could decline. As a result you could lose some or all of any investment you may have made or may make in our common stock.

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

We had a loss of \$6.3 million after taxes for the nine months ended April 30, 2011 (the “Nine Months”), a loss of \$6.8 million after taxes for the fiscal year ended July 31, 2010 (“Fiscal 2010”), and a loss of \$7.1 million after taxes for the fiscal year ended July 31, 2009. As of April 30, 2011, we had an accumulated deficit of approximately \$51.6 million. We expect to continue to have losses in future periods. 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.

None of our existing agreements contain provisions that guarantee us any minimum revenues. In December 2010, we announced that High Scope Trading LLC (“High Scope”) of Dubai had contractually committed to Richmond more than \$144 million in orders for SDC-based products over a ten year period in exchange for exclusive distribution in the Middle East. However, similar to agreements that we or Richmond have with other parties we are working with to establish our novel technology, these minimums are not guaranteed and the remedy for High Scope’s failure to perform is limited to their loss of exclusivity, meaning that some or all of High Scope’s contractual commitments may not be met and investors should not assume any of these payments will be received. The first order under this arrangement was shipped in October 2010, however we recorded the sale as deferred revenue as collection was not reasonably assured at the time of shipment. As of June 10, 2011, \$322,100 related to this sale remains uncollected. We cannot assure you that it will ever be collected, in whole or in part.

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.

Our future capital needs are uncertain, and we currently expect that we will need additional funds in the future, which may not be available on acceptable terms or at all

Our cash outflows for operating activities and for investments in patents and fixed assets were \$4.8 million in the Nine Months and \$5.9 million in Fiscal 2010. 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 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 and other payments, which cannot be postponed.

We expect that we will need to increase our liquidity and capital resources in the fiscal year ending July, 31 2011 (“Fiscal 2011”) and in future periods by one or more measures, which may include reducing operating expenses, raising additional financing through the issuance of debt, equity (whether through our ATM Program or otherwise), 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 would 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, or to reduce or cease operations. If adequate funds are not available when needed, we may be required to 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 issue equity or convertible debt securities to raise additional funds, our existing stockholders may experience dilution, and in addition 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.

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

In addition to 39,749,216 shares of common stock issued and outstanding, we currently have 3,934,350 shares reserved for issuance under equity compensation plans, vested and unvested options, and warrants, with a weighted-average exercise price of approximately \$3.52; and 39,900 shares of unvested restricted stock; a total of 3,974,250 shares reserved for issuance. 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.

The future issuance of common stock or preferred stock may, among other things, decrease existing stockholders' percentage equity ownership and, depending on the price at which they are issued, could be dilutive to the voting rights of existing stockholders and have a negative effect on the market price of the common stock.

On February 20, 2011, our stockholders approved a proposal to change in our state of incorporation from California to Delaware (the "Reincorporation") and which includes, among other items, an increase in our authorized common stock from 50,000,000 shares to 100,000,000 shares. The Reincorporation was consummated on March 24, 2011 and, as a result, our authorized common stock was increased to 100,000,000 shares. We review and evaluate potential capital raising activities, transactions and other corporate actions on an ongoing basis to determine if such actions would be in the best interests of the Company and our stockholders. As is true for shares presently authorized but unissued, the future issuance of authorized common stock may, among other things, decrease existing stockholders' percentage equity ownership and, depending on the price at which such common stock is issued, could be dilutive to the rights, preferences and privileges of existing stockholders and have a negative effect on the market price of our common stock.

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, attracting and retaining employees by the issuance of additional securities under our various equity compensation plans, or other transactions and corporate purposes that our Board of Directors deems are in the Company's 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, the Board could sell shares of common stock in a private transaction to purchasers who would oppose a takeover or favor our current Board. Although the increase in authorized shares has been prompted by business and financial considerations and not by the threat of any known or threatened hostile takeover attempt, the effect of the increase in authorized shares could facilitate future attempts by the Company to oppose changes in control of the Company and perpetuate our management, including transactions in which the stockholders might otherwise receive a premium for their shares over then current market prices. 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, the Board could also issue 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 our efforts to achieve or maintain market acceptance of our core SDC technology are not successful, we are unlikely to attain profitability

We have invested a significant portion of our time and financial resources in the development and commercialization of our core SDC technology. Although we believe SDC has applications in multiple industries, we expect that sales of SDC 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, 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 products 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. Other risks involved in introducing these new products include liability for product effectiveness and safety, and competition from existing or emerging sources. Additionally, government regulation in the U.S. and in other countries is a significant factor in the development, manufacturing and marketing of many of our products and in our ongoing research and development activities. All products derived from SDC require approval by government agencies prior to marketing or sale in the U.S. or overseas. Complying with applicable government regulations and obtaining necessary clearances or approvals can be time consuming and expensive, and there can be no assurance that regulatory review will not involve delays or other actions adversely affecting the marketing and sale of our products. For example, regulatory review of SDC by the U.S. EPA has historically been time consuming and expensive, due primarily, we believe, to the novel nature of our technology. While we cannot accurately predict such regulatory processes, we expect the review process to remain time consuming and expensive as we, or our partners, apply for approval to market new formulations or to make additional claims. We also cannot predict the extent or impact of future legislation or regulation in the U.S. or overseas.

Some of our new bioscience applications for healthcare markets, food preparation markets and agriculture markets will also require approval by government agencies prior to marketing or sale in the U.S. or overseas. Until we, or our partners, obtain approvals from the appropriate regulatory authorities for future potential product applications, if ever, we will not be able to market or sell such products, which would limit our revenues. Even after approval, if any, we will remain subject to changing governmental policies regulating antimicrobial products.

We are subject to intense competition

Our SDC-based products compete in highly competitive markets dominated by prominent chemical and pharmaceutical companies. Many of our competitors have significantly greater financial resources than we do in multiple areas that include sales, marketing, branding, product development and research. 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. Competition by existing or potential chemical and pharmaceutical manufacturers and distributors could substantially limit or eliminate our potential market share and ability to profit from our products and technologies. 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 and/or diligent in doing so, which would have a materially adverse effect on our business, financial condition and results of operations.

We have limited product distribution experience, and we expect to rely on third parties who may not successfully sell our products

We have limited product distribution experience and have relied primarily on product distribution arrangements and/or sales and marketing services provided by third parties. We have also licensed or plan to license our technology to certain third parties for commercialization of multiple applications. We expect to enter into additional distribution agreements and licensing agreements in the future, and we may not be able to enter into these additional agreements on terms that are favorable to us, if at all. Our future revenues from sales of our products, if any, will depend on the success of the efforts of these third parties, however we may have limited or no control over the distribution activities of these third parties, who could sell competing products and/or may devote insufficient sales efforts to our products.

In years prior to the current fiscal year, we sold SDC concentrate to BASF under an agreement whereby BASF resold the concentrate under its own brand names within the global personal care, household and institutional markets. During the Nine Months, we terminated this agreement, and we are currently evaluating alternatives for distribution in these markets. We may not be successful in finding such alternatives on terms and/or on a timeline that is acceptable to us.

In Fiscal 2010, we commenced selling our EPA-registered hard surface disinfectant under the label, IV-7 Ultimate Germ Defense™ (“IV-7”) through an alliance with a Dallas-based sales and marketing organization, Richmond Sciences, LLC (“Richmont”), to U.S. commercial distributors and commercial customers; and in November 2010 we commenced selling our EPA-registered disinfectant/food contact surface sanitizer under the label IV-7 Ultimate Germ Defense for Food Contact Surfaces™ through the same arrangement with Richmont. In addition, in October 2010 Richmont established distribution of SDC-based products in the Middle East region; however, on April 25, 2011, we communicated to Richmont our intent to terminate our relationship with Richmont for breach, and we currently expect our agreement with Richmont to terminate in late June 2011. In preparation for the termination of our relationship with Richmont, we developed and obtained EPA registration of our proprietary new brand, PURE™ Hard Surface disinfectant and food contact surface sanitizer to resume direct control of our sales through a restructuring of our sales strategy and operations. We intend to now market and sell our PURE Hard Surface product into consumer, commercial and institutional markets, including the food processing industry, though both alternative and traditional distribution channels. In April 2011, we launched the PURE Hard Surface product and have commenced sales. We are also currently in negotiation with several entities regarding international distribution of our SDC-based disinfectant and water treatment products, although we can not assure you that these negotiations will be successful. Although we anticipate that resuming direct control of our sales and marketing may result in increased revenue, to do so we must successfully enact various operational changes in our business, including making significant investments in our own sales and marketing organization and expect in some cases to pay sales commissions to sales representatives. We may not be successful in our efforts to sell the PURE Hard Surface Product,

our other existing products or our future products.

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 on third parties to whom we license rights to our technology to develop products containing SDC for many of the applications for which we believe SDC-based products have, or may have, market opportunities. Generally, under our contractual relationships with these third parties, we 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, 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 we are unable to successfully develop or commercialize new applications of our SDC technology, our operating results will suffer

In addition to its use on inanimate surfaces, we believe that our SDC technology also shows promise as a broad-spectrum antimicrobial for use in human and veterinary healthcare products. We or our partners plan to pursue additional EPA, FDA and other required regulatory approvals for other applications. We have entered into agreements with FTA Bioscience, LLC ("FTA") for the development and commercialization of certain FDA regulated SDC-based products. However, we do not exercise any control over FTA. FTA's resources are limited and progress to date on all indications has been slow. Any products developed may never achieve regulatory approval or be commercialized. 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 on our operating results.



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;
- 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.

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.

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

We are a bioscience company focused on the marketing and continued development of our SDC antimicrobial technology. The risks, regulatory hurdles and costs of doing business in our target markets are high. Government regulation in the U.S. and in other countries is a significant factor in the development, manufacturing and marketing of our products, and in our ongoing research and development activities. We believe that all products derived from SDC, or products that may be derived from SDC 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 time consuming and expensive, and there can be no assurance that regulatory review will not involve delays or other actions adversely affecting the marketing and sale of our products. For example, regulatory review of SDC by the EPA has historically been time consuming and expensive, due in part, we believe, to the novel nature of our technology. While we cannot accurately predict the outcome of any pending or

future regulatory review processes, we expect such processes to remain time consuming and expensive as we, or our partners, apply for approval to market new formulations or to make new or additional claims. We also cannot predict the extent or impact of future legislation or regulation in the U.S. or in foreign markets.

Some of our potential bioscience applications, for example those aimed at healthcare, food preparation and agriculture markets, will also require approval by government agencies prior to marketing or sale in the U.S. or in foreign markets. If or until we, or our partners, obtain approvals from the appropriate regulatory authorities, we would not be able to market or sell such products, which would limit our revenues. Even after approval, if any, we will remain subject to changing governmental policies regulating antimicrobial products.

Our 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. We currently have EPA registration for our 2400-parts per million (ppm) technical grade SDC concentrate (trade name Axenohl), as well as for our Axen and Axen30 hard surface disinfectant products. In addition, in August 2009, the EPA published an amendment to the Federal Register establishing a concentration limit for silver in end use solutions eligible for tolerance exemption, specifically in the form of 50 ppm silver dihydrogen citrate. Concurrently with the amendment, the EPA registered our 50 ppm indirect food contact surface sanitizer product. We subsequently submitted a registration to the EPA to add the food contact surface sanitizer claims to our previously-registered 30 ppm hard surface disinfectant formula, SDC3A. The EPA registered the disinfectant/sanitizer formula in April 2010, and we immediately filed a federal sub-registration and subsequent state registrations for the disinfectant/sanitizer product. 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. By November 2010, the disinfectant/sanitizer product was registered in all 50 states, however there can be no guarantee that a particular state, or any state, will allow the continued sale of any existing SDC-based products, or will allow the sale of any new applications of our products in future periods.

We are responsible for the accuracy of any claims made by us or our partners or distributors related to SDC-based products, and their consistency with claims approved by the regulatory authorities, including the EPA, any state, or any foreign regulatory authority. We have limited ability to monitor or regulate claims made by our partners and distributors, including but not limited to claims made in marketing materials, internet sites, by e-mail, or verbally. Failure by our partners or us to comply with approved label claims could result in fines, or to the withdrawal of approval for us or our partners and distributors to market our products, in any or all jurisdictions, and/or our failure to successfully commercialize SDC or otherwise achieve revenue growth.

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 also 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. However, the introduction of additional regulated antimicrobial products in the U.S., or in markets outside the U.S., could take several years, or may never be achieved. Existing state, federal or international approvals may not be maintained. Additionally, doing business internationally carries a great deal of risk with regard to foreign government regulation, financial instruments and banking, currency fluctuation, and many other factors.

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, resulting in additional costs to obtain these items, which may in turn inhibit our ability to supply products to our customers.

In many of our distribution and development agreements, we are unable to raise our product prices to our customers 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.

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 have an adverse effect on our business, financial condition, or results of operations

The EPA regulates the registration, manufacturing, and sales and marketing of many of our products, and those of our distributors and partners, in the United States. Significant government regulation also exists in overseas markets. Compliance with applicable regulatory requirements is subject to continual review and is monitored through periodic inspections and other review and reporting mechanisms.

Failure by us or our partners to comply with current or future governmental regulations and quality assurance guidelines could lead to temporary manufacturing shutdowns, product recalls or related field actions, product shortages, delays in product manufacturing, and significant cost to us. 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, declining sales, and/or our failure to successfully commercialize SDC or otherwise achieve revenue growth.

In addition, the FDA and comparable agencies in many foreign countries impose substantial limitations on the introduction of new products through costly and time-consuming laboratory and clinical testing and other procedures. The process of obtaining FDA and other required regulatory approvals is lengthy, expensive and uncertain. There is no guarantee that we, or our partners, will be able to obtain the resources necessary to further develop our technology or obtain regulatory approvals, or that the products will be successful in meeting the strict criteria imposed by the FDA. It may be several years before we, or any third party to whom we grant rights to use our silver ion technologies, are able to introduce any FDA regulated antimicrobial pharmaceutical or medical device products containing our technology.

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, and contractual restrictions, to protect the proprietary aspects of our technology and business. These legal protections afford only limited protection for our intellectual property and trade secrets. Despite efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our proprietary technology or otherwise obtain and use information that we regard as proprietary. We may not have sufficient resources to defend or litigate our proprietary rights, and we cannot assure you that our means of protecting such rights will be adequate. The infringement of such rights could have a material negative impact on our business and on our results of operations.

We own seven U.S. patents related to our SDC technology. The lives of our patents are not indefinite, and the value to us of some or all of the patents may be limited by their term.

In addition to U.S. patents and trademarks, we have filed for foreign patent applications and trademark registrations. We may not be successful in obtaining any of these patents and trademarks, whether in the U.S. or overseas, and we may be unable to obtain additional patent and trademark protection in the future. Furthermore, legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain. It is possible that, despite our efforts, competitors or others will create and use products in violation of our patents and/or adopt service names similar to our service names or otherwise misappropriate our intellectual property. Such patent infringement or misappropriation could have a material adverse effect on our business. Any unauthorized production of our SDC-based products, whether in the U.S. or overseas, may reduce our own sales of SDC-based products, thereby reducing, perhaps significantly, our actual or potential profits. Adopting similar names and trademarks by competitors could lead to customer confusion. Any claims or customer confusion related to our trademarks could negatively affect our business.

Litigation may be necessary to enforce our intellectual property rights and protect our trade secrets. If third parties prepare and file applications in the U.S. or other countries that claim trademarks used or registered by us, we may oppose those applications and may be required to participate in proceedings before the regulatory agencies who determine priority of rights to such trademarks. We may not have sufficient resources to defend our trademarks and any litigation or adverse priority proceeding could seriously harm our business and operating results.

If we are found to have violated the trademark, trade secret, copyright, patent or other intellectual property 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. It could also be necessary for us to pay a substantial amount in the future if the rights holders are willing to permit us to continue to use the intellectual property rights. Either having to cease use or pay such amounts could make us much less competitive and could have a material adverse impact on our business, operating results and financial condition.

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 United States. Many countries have a “first-to-file” trademark registration system. As a result, we may be prevented 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. Our means of protecting our proprietary rights may not be adequate, and our competitors, or potential competitors, could independently develop similar technology.

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. Any such claim of liability, whether meritorious or not, could be time-consuming and/or result in costly litigation. 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, and you may lose some or all of any investment you have made, or may make, in our common stock.

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 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 or

actions could from time to time be filed against us and/or our executive officers and directors. Such lawsuits and actions are not uncommon, and we cannot assure you that we will always be able to resolve such disputes or actions on terms favorable to us, or that there will 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 Securities Exchange Act of 1934, as amended (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. 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, 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 of 2002 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, and we could therefore be subject to sanctions or investigation, or the delisting of our common stock, by regulatory authorities such as the SEC or the NASDAQ Capital Market. 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 and we recently appointed a new Chief Financial Officer

Our success depends largely upon the continued services of our executive officers and other key personnel. Pursuant to the employment laws of the State of California, 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 March 11, 2011, we announced that our former Chief Financial Officer, Andrew Buckland, tendered his resignation from his position as our Chief Financial Officer. Mr. Buckland also previously served as our Principal Financial Officer and our Principal Accounting Officer. Mr. Buckland's last day at the Company was March 25, 2011. On April 28, 2011, Michael L. Krall was appointed as our Interim Chief Financial Officer, Principal Financial Officer and Principal Accounting Officer, each effective April 28, 2011. On June 9, 2011, we announced the appointment of Craig Johnson as our Chief Financial Officer, effective August 1, 2011. With his appointment, Mr. Johnson will also serve as our Principal Financial Officer and Principal Accounting Officer. Concurrent with the effectiveness of Mr. Johnson's appointment, Michael Krall will relinquish his roles as Interim Principal Financial Officer and Interim Principal Accounting Officer and continue in his role as our President and Chief Executive Officer. Mr. Johnson has not previously worked with our existing executive management team. We cannot assure you that this management transition will not result in some disruption of our business. If our new Chief Financial Officer is unable to work with our existing management team to implement our strategies, manage our operations and accomplish our objectives, our business, operations and financial results could be impaired.

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 growth.

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 June 10, 2011, the closing market price of our common stock ranged from \$1.02 per share to \$3.06 per share, and the monthly trading volume varied from 1.9 million shares to 15.4 million shares. In the future, the market price of our common stock may continue to be volatile and could fluctuate substantially due to many factors, including:

- actual or anticipated fluctuations in our results of operations;
- 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;
- the sale by us of our common or preferred stock or other securities, or the anticipation of sales of such securities;
  - sales or anticipated sales of our common stock by our insiders (management and directors);
  - the trading volume of our common stock, particularly if such volume is light;
  - 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, among other factors;
  - 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.

Sales of our common stock in our ATM Program, or the perception that such sales may occur, could cause the market price of our common stock to fall

On April 29, 2011, we entered into a Sales Agreement with C. K. Cooper & Company ("CKCC"), an investment banking firm, under which we may issue and sell shares of our common stock for consideration of up to \$7.0 million, from time to time in an at the market equity offering program (the "ATM Program"), with CKCC acting as our agent. As of June 10, 2011, we have sold 2,391,030 shares of our Common Stock for net proceeds of \$2,908,000 pursuant to the ATM Program. Continued sales of our common stock, if any, under the ATM Program will depend upon market conditions and other factors to be determined by us and may be made in negotiated transactions or transactions that are deemed to be "at the market offerings" as defined in Rule 415 under the Securities Act. The issuance from time to time of these new shares of common stock, or our ability to issue these new shares of common stock in this offering, could have the effect of depressing the market price of our common stock.

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 will need to continue to 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. If we fail to maintain the standards required now or in future by the NASDAQ Stock Market, our common stock could be delisted. Such delisting could cause our stock to be classified as "penny stock," among other potentially detrimental consequences, any of which could significantly impact your ability to sell your shares or to sell your shares at a price that you may deem to be acceptable.

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, 2010, we had federal and California tax net operating loss carry-forwards of approximately \$56.3 million and \$46.2 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 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 will begin expiring in Fiscal 2011 unless previously utilized, and will completely expire in the fiscal year ending July 31, 2029. In the two fiscal years ending July 31, 2011 and 2012, \$3.3 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, 2029. Our California tax loss carry-forwards will begin to expire in the year ending July 31, 2014, and will completely expire in the fiscal year ending July 31, 2029. 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.

We may never pay dividends

We have never paid any dividends and do not anticipate paying dividends in the foreseeable future. The future payment of dividends, if any, is dependent on the discretion of our Board, our earnings, our financial condition and other business and economic factors that our Board may consider relevant.

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 by-laws 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 issue 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. 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 4. (REMOVED AND RESERVED)

ITEM 6. EXHIBITS

A. Exhibits

The following Exhibits are filed as part of this report pursuant to Item 601 of Regulation S-K:

- 2.1 -- Agreement and Plan of Merger, dated March 24, 2011, by and between Pure Bioscience and Pure Bioscience, Inc. (Incorporated by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K, dated March 24, 2011 and filed with the Commission on March 25, 2011.)
- 3.1 -- Certificate of Incorporation of Pure Bioscience, Inc., a Delaware corporation (Incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K, dated March 24, 2011 and filed with the Commission on March 25, 2011.)
- 3.2 -- Bylaws of Pure Bioscience, Inc., a Delaware corporation (Incorporated by reference to Exhibit 3.2 of the Company's Current Report on Form 8-K, dated March 24, 2011 and filed with the Commission on March 25, 2011.)
- 10.1 -- Form of Sales Agreement, dated April 29, 2011. (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K, dated April 28, 2011 and filed with the Commission on April 29, 2011.)
- 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\*

\* Filed herewith.

Signatures

Pursuant to the requirement 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.

By: /s/ Michael L. Krall  
Michael L. Krall  
President / Chief Executive Officer / Interim Chief Financial Officer  
(Principal Executive Officer, Principal Financial Officer and Principal Accounting Officer)  
June 13, 2011

