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Oculus Innovative Sciences (Nasdaq/OCLS)

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BUY Catalysts ahead for fiscal 2016
Oculus markets the Microcyn line of anti-infective and wound care products
Investment Highlights

1) Oculus Innovative Sciences (“Oculus”) reported financial results for their Q4/2015 (March) quarter and filed their 2015 annual 10-K earlier this month, including total revenues of \$3.98 million, up 36.6% year-over-year, with a net loss of \$1.5 million or (\$0.11) per share, as compared with a net gain of \$7.5 million or \$0.99 per share for the same period one year ago. Results for last year’s Q4/2014 included a one-time gain of \$11.1 million, or \$1.48 per share. For fiscal 2015, revenues came in at \$13.9 million, up slightly from \$13.7 million in fiscal 2014, while loss from operations was \$6.7 million, as compared with a similar loss of \$6.1 million in 2014. Our estimate for the 2015 fiscal year was revenue of \$13.1 million, with a loss from operations of \$6.9 million, so Oculus exceeded our most recent forecast. Revenues in Q4/2015 were led by a 96% increase in product revenues in Mexico due to initial stocking at new pharmacies by Laboratorios Sanfer following their recent purchase of former partner More Pharma, an increase of \$336,000 (or 117%) in the US from higher sales of new dermatology and acute care products, and an increase of \$239,000 or 55% in Europe and Rest of World thanks to new advanced tissue care product line extensions and new distributors in Europe as well as growth in the Middle East through new contracts. Product revenue growth during the fourth quarter was partially offset by reduced product licensing fees in the animal health segment as Oculus is in the process of replacing its former veterinary products licensee. Product and licensing fee gross margins stayed steady during the quarter at 52%, while total operating expenses increased in Q4/2015, although less than revenue growth, allowing for the reduced operating loss this year. Operating cash burn for the year, as measured by EBITDAS, was essentially flat at a negative \$4.7 million as compared with a negative \$4.6 million in 2014. Oculus had cash on hand of approximately \$6.1 million at the end of the fiscal year (March), as compared to \$5.5 million at the start of the fiscal year; cash was augmented subsequent to year-end by \$4.5 million garnered from the sale of the Company’s stake in Ruthigen (Nasdaq/PULM/Buy).

Current Price \$1.44
Price Target \$4.00

Estimates	F2013A	F2014A	F2015A
Revenue(\$000s)	\$15,452	\$13,668	\$13,854
1Q June	4,051	3,372	3,392 A
2Q September	4,526	4,089	3,264 A
3Q December	3,540	3,293	3,218 A
4Q March	3,335	2,914	3,980 A
Prev. Rev. Estimate (\$000s)			

EPS	(\$1.30)	(\$0.44)	(\$0.85)
1Q June	(0.14)	(0.26)	(0.01) A
2Q September	(0.33)	(0.21)	(0.08) A
3Q December	(0.37)	(0.09)	(0.69) A
4Q March	(0.44)	0.99	(0.11) A
Previous EPS Estimate			

P/E (x)	N/A	N/A	N/A
EBITDA/Share	(\$1.18)	(\$0.65)	(\$0.48)
EV/EBITDA (x)	N/A	N/A	N/A

Stock Data	
52-Week Range	\$0.62-\$3.22
Shares Outstanding (mil.)	15.1
Market Capitalization (mil.)	\$21.7
Enterprise Value (mil.)	\$15.7
Debt to Capital (3/15)	0.7%
Book Value/Share (3/15)	\$0.80
Price/Book	1.8 X
Average Trading Volume (10-Day)	770,000
Insider Ownership	8.2%
Institutional Ownership	10.7%
Short interest	264,000
Dividend / Yield	\$0.00/0.0%



Price target and ratings changes over the past 3 years:
 Initiated - August 17, 2009 – Buy - Target \$4.50
 Price target lowered to \$2.25 - March 1, 2012
 Price target adjusted to \$12.00 - April 10, 2013
 Rating lowered to Neutral - June 18, 2013
 Rating raised to Buy - April 30, 2014 - Price Target \$7.50
 Price target lowered to \$4.00 - February 18, 2015

2) On the Company's recent fourth quarter earnings conference call, Oculus management related that one of its key strategies for current fiscal year 2016E will be to achieve double-digit product revenue growth, with the caveat that strong stocking-related revenues in Mexico in Q4/2015 might adversely affect first quarter revenues in that country. Thus, we are implementing estimates for 2016E for Oculus, including revenues of \$15.2 million, with product and product licensing fees of \$14.3 million, or 10% above levels of 2015, and service revenues relatively flat at \$900,000. Our revenue estimates include solid growth in both the US and Europe/ROW, with slower growth in Mexico primarily due to the strong fourth quarter 2015 revenues recently posted in that market. Our assumptions also include some improvement in product gross margins, to 56.6% in 2016E from 54.5% overall in 2015, and level to slightly reduced operating expenses this year due to recent belt-tightening measures implemented by Oculus. Overall, we are estimating that Oculus will be able to reduce its operating loss in 2016E to \$5.1 million (from \$8.2 million in 2015) and also reduce its loss per share to (\$0.33) in 2016E from (\$0.85) in 2015. In terms of EBITDA or operating cash flow, our estimate is approximately (\$0.20) per share EBITDA loss, or \$3-\$4 million in operating cash burn (depending on capital expenditures needed for growth), well within current levels of cash on hand of over \$10 million for Oculus following the recent proceeds from the sale of Ruthigen stock..

3) Oculus investors can look forward to a number of new product approvals and/or launches this fiscal year, both in the US and overseas. Following the FDA approval earlier this month of Alevecyn Spray Gel for atopic dermatitis in both prescription and over-the-counter formulations, expected to launch in July, Oculus plans to launch an additional four products in the first or second fiscal quarter timeframe, through its new US-based direct dermatology sales force. Further down the road, Oculus expects to launch six new products through the end of the fiscal year into the US dermatology market. In Mexico, new partner Sanfer is considerably larger than More Pharma, which it acquired last fiscal year, with more pharmacies served in that large geographically-diverse country, and Oculus is targeting same-unit growth in the 10%-20% range in Mexico, offset to some extent possibly on a dollar basis due to a strong US\$. In Europe, new CE Mark approvals in the dermatology market has already shown success related to growth in unit shipments, and Oculus intends to add more distribution strength on a country-by-country basis in Europe to drive additional growth this fiscal year. Finally, after launching a number of Microcyn AH-branded products into the animal health market late in fiscal 2015, Oculus hopes its new distribution partner will help lead to a rebound in these (high-margin) royalty revenues in 2016E. Although Ruthigen's recent merger into the very well-financed Pulmatrix could create additional value for Oculus' prescription-oriented anti-infective assets through future manufacturing revenues and royalty fees, we do not expect additional contribution from this area this fiscal year, although following or even leading up to an August 2016 deadline investors could receive positive news flow in this area.

Conclusion/Stock Valuation

Oculus' share price has rebounded this year following recent strengthening of the Company's balance sheet and positive new product approvals. Still, with expected revenue growth in most of the Company's segments, the aforementioned stronger balance sheet, and a number of new product-related catalysts expected as this fiscal year progresses, we believe recent share momentum in OCLS shares can continue this year, and thus, we are maintaining our Buy rating on OCLS shares and our 12-18 month price target of \$4.00, based on a three stock comparable company group, including NovaBay Pharmaceuticals (NYSE MKT/NBY/Not Rated), Cubist Pharmaceuticals (Nasdaq/CBST/NR) and Medicis Pharmaceutical (based on its purchase price in 2012 by Valeant Pharmaceuticals (NYSE/VRX/NR)), using the price/revenue multiple metrics. (For full description of our most recent price target for OCLS, please refer to our Company Update dated February 18, 2015.)

Risk Factors

In addition to normal economic and market risk factors that impact most equities and the common risks shared by Oculus Innovative Sciences with other companies in the industry, we believe an investment in OCLS involves the following risks:

- **FDA and regulatory risks** – Oculus is subject to regulatory review for its ongoing research and development activities, principally the US Food and Drug Administration but also with other regulatory agencies as well, including in Europe, Latin America and Asia. In addition, the manufacture and handling of commercial quantities of its Microcyn products are subject to additional oversight and regulation. There can be no assurance that the Company will receive regulatory/manufacturing approval for its products.
- **Reliance on joint venture partners and/or additional capital** — Currently, Oculus has enough cash on hand to fund ongoing research and marketing development programs into fiscal 2017 (ending March), approximately. Alternatively, the Company could reach or near operating cash break-even, and meeting this objective would eliminate the need to raise additional equity capital. The Company could also continue to obtain funds through additional partnerships, in particular for prescription products or in new therapeutic or geographic markets. Currently, the Company relies on several marketing partners and distributors to drive sales of its products; should any of these partners develop financial difficulties this could diminish or even eliminate revenues from certain geographic areas or product lines.
- **Need to defend patents and other intellectual property** – At present, the Company’s existing patent portfolio on its current product line is extensive and has been defended in US courts on at least one occasion. However, as sales of its Microcyn-based products increase, this success may attract competitors and require additional expenses related to patent defense and enhancement.
- **Currency fluctuations** – Currently, Oculus derives a large portion of its revenues from foreign sources, including Mexico, and is susceptible to currency fluctuations which can adversely affect revenues and gross margins. However, with new approvals and partnerships in the US, the Company expects to derive a smaller portion of its revenues and cash flows from international sources in the future.
- **Limited stock liquidity** – Trading volume in Oculus stock is comparatively light at an average of 770,000 shares per day. As such, news regarding Oculus, its target market, and/or competitors could lead to significant volatility in the stock price.

Robert M. Wasserman

Oculus Innovative Sciences, Inc.
Consolidated Statements of Income
 (In 000s, except per share data)

FYE March	2009	2010	2011	2012	1Q13	2Q13	3Q13	4Q13	2013	2014	2015	2016E
					June	September	December	March	March	March	March	March
Revenues												
Product and product licensing fees	\$4,415	\$6,298	\$8,826	\$11,853	\$3,816	\$4,264	\$3,357	\$3,146	\$14,583	\$12,723	\$12,995	\$14,300
Service	973	1,066	928	891	235	262	183	189	869	945	859	900
Total revenues	\$5,388	\$7,364	\$9,754	\$12,744	\$4,051	\$4,526	\$3,540	\$3,335	\$15,452	\$13,668	\$13,854	\$15,200
Cost of revenues												
Product	1,673	2,633	2,876	3,254	988	1,092	906	990	3,976	4,510	5,908	6,200
Service	913	853	737	776	179	234	163	157	733	761	658	650
Total cost of revenues	2,586	3,486	3,613	4,030	1,167	1,326	1,069	1,147	4,709	5,271	6,566	6,850
Gross Profit	2,802	3,878	6,141	8,714	2,884	3,200	2,471	2,188	10,743	8,397	7,288	8,350
Operating Expenses:												
Research and development	6,252	1,996	2,046	1,981	532	513	509	669	2,223	2,887	1,533	1,500
Selling, General and administrative	13,857	9,898	11,600	13,200	2,847	3,504	2,642	2,901	11,894	11,561	12,414	12,000
Operating income (loss)	(17,307)	(8,016)	(7,505)	(6,467)	(495)	(817)	(680)	(1,382)	(3,374)	(6,051)	(6,659)	(5,150)
Interest expense	(437)	(8)	(406)	(931)	(288)	(280)	(275)	(264)	(1,107)	(1,058)	(2)	0
Other (income) expense, net	88	(208)	152	69	1,228	(422)	(957)	(799)	(950)	10,843	(1,542)	100
Income (loss) before tax	(17,656)	(8,232)	(7,759)	(7,329)	445	(1,519)	(1,912)	(2,445)	(5,431)	3,734	(8,203)	(5,050)
Preferred stock dividends	0	0	0	0	(1,062)	0	0	0	(1,062)	0	0	0
Net income (loss)	(17,656)	(8,232)	(7,759)	(7,329)	(617)	(1,519)	(1,912)	(2,445)	(6,493)	3,734	(8,203)	(5,050)
Basic income per share	(\$7.62)	(\$2.51)	(\$2.06)	(\$1.87)	(\$0.14)	(\$0.33)	(\$0.37)	(\$0.44)	(\$1.30)	\$0.54	(\$0.85)	(\$0.33)
Diluted income per share	(\$7.62)	(\$2.51)	(\$2.06)	(\$1.87)	(\$0.14)	(\$0.33)	(\$0.37)	(\$0.44)	(\$1.30)	\$0.54	(\$0.85)	(\$0.33)
Basic shares outstanding	2,317	3,285	3,768	3,912	4,514	4,659	5,126	5,604	4,976	6,882	9,657	15,100
Diluted shares outstanding	2,317	3,285	3,768	3,912	4,514	4,659	5,126	5,604	4,976	6,898	9,657	15,100
Key ratios:												
Product/Royalties revenue growth	53.2%	42.7%	40.1%	34.3%	40.8%	25.8%	29.3%	-0.3%	23.0%	-12.8%	2.1%	10.0%
Gross margin-products	62.1%	58.2%	67.4%	72.5%	74.1%	74.4%	73.0%	68.5%	72.7%	64.6%	54.5%	56.6%
R&D/revenue	116.0%	27.1%	21.0%	15.5%	13.1%	11.3%	14.4%	20.1%	14.4%	21.1%	11.1%	9.9%
S, G & A/revenues	257.2%	134.4%	118.9%	103.6%	70.3%	77.4%	74.6%	87.0%	77.0%	84.6%	89.6%	78.9%
Non-cash items	\$3,335	\$2,245	\$2,793	\$2,730	\$625	\$450	\$525	\$1,172	\$2,772	\$2,600	\$2,024	\$2,100
Tax Rate	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Cash Flow/share	(\$6.18)	(\$1.51)	(\$1.32)	(\$1.18)	\$0.00	(\$0.23)	(\$0.27)	(\$0.23)	(\$0.73)	(\$0.67)	(\$0.48)	(\$0.20)
EBITDA/share	(\$6.14)	(\$1.21)	(\$1.28)	(\$1.16)	(\$0.03)	(\$0.32)	(\$0.46)	(\$0.37)	(\$1.18)	(\$0.65)	(\$0.48)	(\$0.20)

Balance Sheets
Quarterly Earnings Comparisons

Assets:	(\$000s)		Revenues (in \$000)					Total
	3/31/14	3/31/15	June	Sept	December	March		
Cash and equivalents	\$5,480	\$6,136	2008	866	977	1,066	926	3,835
Accounts receivable, net	1,790	1,517	2009	1,211	1,481	1,221	1,475	5,388
Inventories, net	1,088	1,402	2010	1,847	1,672	1,613	2,232	7,364
Prepaid expenses & other	1,184	592	2011	2,264	2,466	2,313	2,711	9,754
Total current	9,542	9,647	2012	2,940	3,663	2,790	3,351	12,744
Property & equip., net	971	795	2013	4,051	4,526	3,540	3,335	15,452
Other assets	10,278	4,606	2014	3,372	4,089	3,293	2,914	13,668
TOTAL ASSETS	\$20,791	\$15,048	2015	3,392	3,264	3,218	3,980	13,854
			2016E					15,200
Liabilities:			Earnings per Share					
Accounts payable	\$736	\$932	2008	(2.97)	(3.09)	(2.80)	(2.36)	(11.18)
Accrued expenses	6,693	1,562	2009	(2.29)	(3.04)	(1.46)	(0.91)	(7.62)
Long-term debt - current portion	143	87	2010	(1.28)	(0.58)	(0.38)	(0.40)	(2.51)
Total current	7,572	2,581	2011	(0.63)	(0.41)	(0.60)	(0.42)	(2.06)
Long-term debt	4		2012	(0.57)	(0.22)	(0.66)	(0.43)	(1.87)
Other long-term	1,152	413	2013	(0.14)	(0.33)	(0.37)	(0.44)	(1.30)
Total long-term liabilities	1,156	413	2014	(0.26)	(0.21)	(0.09)	0.99	0.54
Stockholders' equity	12,063	12,054	2015	(0.01)	(0.08)	(0.69)	(0.11)	(0.85)
TOTAL LIAB & EQ	\$20,791	\$15,048	2016E					(0.33)

Revenues by Segment

Revenues by Geographic area (FYE March)	2014	2015	2016E
Product-related revenues			
United States	1,406	1,988	2,400
Mexico	3,758	5,053	6,000
Europe and rest-of-world	2,046	2,908	3,500
Total product	7,210	9,949	11,900
Product license fees and royalties			
Sanfer Labs/More Pharma	1,501	1,499	1,600
Innovacyn/Veterinary	3,100	1,120	500
Exilitis and Quinnova	807	427	300
Other	105	0	0
Total license fees and royalties	5,513	3,046	2,400
Service revenues	945	859	900
Total	\$13,668	\$13,854	\$15,200

Source: Dawson James Securities, Inc. estimates; Company documents

Important Disclosures:
Price Chart:

Price target and ratings changes over the past 3 years:

Initiated – August 17, 2009 – Buy - Target \$4.50
 Lowered price target to \$2.25 – Buy - March 1, 2012
 Adjusted price target to \$12 - Buy – April 10, 2013
 Rating lowered to Neutral - June 19, 2013
 Rating raised to Buy – April 30, 2014 –Price Target \$7.50
 Lowered price target to \$4.00 – Buy – February 18, 2015

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- 1) **Buy:** the analyst believes the price of the stock will appreciate and produce a total return of at least 20% over the next 12-18 months;
- 2) **Neutral:** the analyst believes the price of the stock is fairly valued for the next 12-18 months;
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	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	18	75%	12	67%
Market Perform (Neutral)	6	25%	4	67%
Market Underperform (Sell)	0	0%	0	0%
Total	24	100%	16	67%

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