Zacks Small-Cap Research

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Applied DNA Sciences (APDN-OTC)

APDN: Record financials reported, price target achieved---Neutral

Current Recommendation	**Neutral**
Prior Recommendation	Outperform
Date of Last Change	08/23/2012
Current Price (08/24/12)	$0.14
Twelve- Month Target Price	**$0.18**

OUTLOOK

We are optimistic about the Company's unique technology and two principle anti-counterfeiting and product authentication solutions: SigNature DNA and BioMaterial Genotyping, which can be used in numerous industries. With an ever booming anti-counterfeiting business worldwide, along with its unique technology and broad range of product offering, the Company is well positioned to boost its top line and bottom line in the coming years.

APDN just reported record financials for the three months ending June 30, 2012. We have achieved our price target. Price will consolidate at current level for a while.

SUMMARY DATA

52-Week High	**$0.14**
52-Week Low	**$0.04**
One-Year Return (%)	**100.00**
Beta	**0.87**
Average Daily Volume (sh)	**2,588,007**
Shares Outstanding (mil)	**591**
Market Capitalization ($mil)	**$83**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**3**
Insider Ownership (%)	**23**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2011 Estimate	**N/A**
P/E using 2012 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**High,**
Type of Stock	**N/A**
Industry	**Protection-Sfty**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(In millions of $)

	Q1 (Dec)	Q2 (Mar)	Q3 (Jun)	Q4 (Sep)	Year (Sep)
2011	0.32 A	0.14 A	0.23 A	0.28 A	0.97 A
2012	0.52 A	0.52 A	0.53 A	0.54 E	2.10 E
2013					5.50 E
2014					10.00 E

Earnings per Share
(EPS is operating earnings before non-recurring items)

	Q1 (Dec)	Q2 (Mar)	Q3 (Jun)	Q4 (Sep)	Year (Sep)
2011	-$0.00 A	-$0.01 A	-$0.01 A	-$0.01 A	-$0.03 A
2012	-$0.00 A	-$0.00 A	-$0.00 A	-$0.00 E	-$0.01 E
2013					-$0.01 E
2014					-$0.00 E

Zacks Projected EPS Growth Rate - Next 4 Years % **N/A**

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WHAT'S NEW

APDN Reports Record Financial Results for Fiscal Third Quarter of 2012

On August 14, Applied DNA Science Inc. (APDN) reported record financial results for the fiscal third quarter of 2012 ended June, 2012.

Total revenue in the quarter ending June 30, 2012 reached $0.53 million, compared to $0.23 million for the third quarter of 2011, an increase of 130%. The increase in revenues was substantially generated from sales of the Company's two leading product lines SigNature® DNA and BioMaterial GenoTyping™, which are the principal anti-counterfeiting and product authentication solutions.

Third quarter of 2012 revenue of $0.53 million also beat our estimate of $0.50 million.

Revenues for the nine-month period have increased by 127% year over year, topping $1.5 million for the first time. This is higher than the Company's prior record revenue in any complete fiscal year.

SG&A expenses increased from $1.6 million for the three months ended June 30, 2011 to $1.8 million for the three months ended June 30, 2012. The increase of $171,713 represents an 11% increase over the same quarter in the prior fiscal year and is primarily attributable to the cost of stock-based compensation incurred in the current period compared to the same period last year.

The Company incurred research and development expenses of $99,958 and $47,988 for the three-month periods ended June 30, 2012 and 2011, respectively. The increase is attributable to additional research and development activity needed with current operations.

Total operating expenses increased to $2.0 million for the three months ended June 30, 2012 from $1.7 million for the three months ended June 30, 2011, an increase of $235,129 quarter over quarter, or 14%.

Net loss dropped to $1.4 million (-$0.00) in the current quarter compared to $2.2 million (-$0.01) in the same quarter of 2011. This is a 34% reduction year over year. Net loss of $1.4 million also beat our estimate of $1.7 million.

Due to its business growth, APDN recently has significantly expanded its office, production, and laboratory space and increased its personnel. The expansion reflects the company's continued worldwide growth in production capacity, technology advancement, and global customer support. Those factors are also seen in a steady rise in shipments of its DNA products.

We are very pleased to see that APDN has achieved another strong quarter for fiscal 2012. The Company began fiscal year 2012 with a strong first quarter with revenue of $0.52 million. Second quarter and third quarter have kept the momentum. We believe revenue will continue to grow dramatically in the next few quarters due to new product offerings and new business developments.

While revenue has increased quarter by quarter for the nine months of 2012, SG&A expense has dropped each quarter in the first three quarters of 2012. We are very glad to see revenues increase while expenses are controlled closely.

Sustainable Growth is Supported by Continued New Business Developments

In the past few months, APDN continues to make great progress in business development.

On August 16, 2012, APDN was named by DoD Defense Logistics Agency (DLA), as the provider of authentication services for microcircuits supplied by defense contractors. On August 3, 2012,

DLA posted notice on its DLA Internet Bid Board System (DIBBS) that it will require the use of SigNature® DNA marking on microcircuits.

The number of companies directly affected by the DLA directive is in the hundreds, and includes many of the largest microcircuit manufacturers in the world. APDN reported immediate inquiries from numerous impacted companies.

APDN will sell SigNature DNA marks to chip manufacturers, while for distributors the Company will sell a source-verification marking program, to establish traceability from the moment of marking. The Company also plans to provide DNA marking services directly to those manufacturers who want immediate implementation before establishing marking capability at their own facilities. Once SigNature DNA-marked, the microchips may be authenticated as originals at any stage along the military supply chain, if a participating company has purchased an authentication program from APDN.

The SigNature DNA marking initiative by DLA comes at a critical juncture for the electronics industry, which is facing a new federal law that would strictly enforce new anti-counterfeiting measures by defense contractors.

The DoD Office of the Director, Cost Assessment and Program Evaluation last year projected the value of all semiconductors sold to DoD in fiscal year 2011 to be $3.1 billion. The figure for fiscal year 2012 is projected to be $2.84 billion. These figures include both microchips sold stand-alone ("direct sales") for spare parts or prototyping, and also microchips that are embedded in more complex electronic parts sold to the military ("indirect sales"). Indirect sales may range from amplifiers, to computers to aircraft and missile guidance systems. The market value of semiconductors, both military and commercial in all countries in fiscal year 2011 has been estimated at $302 billion by Gartner.

On August 1, 2012, APDN announced that celebrated guitar maker C.F. Martin & Co. has expanded DNA marking to protect and authenticate its guitar strings.

Martin Guitar produces millions of strings per year, and is one of the leading manufacturers of guitar strings in the world. Martin Guitar strings are made in Navojoa, Mexico.

Martin Guitar, an iconic American brand that is acknowledged as the creator of some of the world's finest musical instruments for over 175 years, has partnered with Applied DNA Sciences to protect its products, brands and intellectual property from counterfeiting and diversion. Since 2011, Martin Guitar has been incorporating its unique "Martin Guitar" botanical DNA mark onto each of its guitars, produced in its factories at Nazareth, Pennsylvania and Navojoa, Mexico. As part of the DNA authentication platform, any guitars made by Martin Guitar from 2011 will be able to be identified and forensically authenticated.

Every year, several thousand dedicated guitar owners attend a special event hosted by Martin Guitar to learn about new products, as well as new technologies.

Martin Guitar selected botanical DNA over other authentication technologies because it can be used to covertly mark a guitar, with its location known only to Martin Guitar, and for the strength in DNA generally in prosecution.

On June 4, 2012, the New York State Center of Excellence in Small Scale Systems Integration and Packaging at Binghamton University (S3IP), New York, and APDN announced the signing of a Memorandum of Understanding calling for collaboration on microelectronics research and commercialization, and other projects. The two organizations aim to embark on various projects, including further advancements in Applied DNA Sciences' forensic authentication and security technologies.

The partnership capitalizes on the skilled staff and advanced facilities at S3IP, combined with the technology, business experience and product lines of APDN. It comes at a time when the defense

industry is searching for new ways to battle the increasing number of counterfeit electronics that have flooded both consumer and the military markets. The partners will aim to commercialize the resulting applications, with the potential to impact the estimated $3.1 billion annual flow of semiconductors to the U.S. military and a global commercial market in semiconductors valued well in excess of $300 billion.

On May 17, 2012, APDN announced that its smartDNA anti-theft system will be used by police in Sweden to deter theft of copper wire and other copper electrical components in the Sweden national rail system.

APDN's smartDNA will be used as evidence marking on the rail system's often-stolen copper wire and other parts. Applied to the metal, a unique, permanent smartDNA mark will forever associate the specific copper directly to a specific crime. The plant-derived DNA is extremely robust, and has proven highly resistant to harsh weather and to criminals' attempts to clean it from stolen product.

The smartDNA security system will be used on a stretch of rail track, in a test beginning shortly. Depending on results, the product could be used nationally on the extensive Sweden rail system.

Theft of copper has become an enormous problem in Sweden and globally. Copper is commonly used in critical infrastructure, such as the rail systems and power grid. On April 10, 2012, rail traffic connecting Stockholm, Malmö, and Copenhagen was brought to a standstill after thieves severed the high-voltage overhead lines in order to steal the valuable copper wire inside.

In the U.S. from 2009-2011, over 24,000 insurance claims were made for theft of copper. Over that time and extending to this month, the market price of copper has skyrocketed by 248%, from $1.66/lb. in January 1, 2009 to $4.13 on May 1, 2012. Copper has become a tempting target for thieves, more than a few of whom have been electrocuted in theft attempts in the U.S. and Sweden. Copper theft has been linked by law enforcement authorities to methamphetamine use and other drug abuse.

We see these business developments positive to the Company's top line growth in the coming quarters. We think all these business developments are indicative of management's commitment to grow its business in a sustainable way.

VALUATION AND RECOMMENDATION

Since our initiation of coverage of APDN in early September, 2010, share price has appreciated from $0.04 then to current $0.14 per share, that has reached our price target of $0.15 per share. We encourage investors to take some profit at this point as the price will consolidate for a while at current level. We therefore change our rating on APDN to Neutral with a new price target of $0.18 per share.

We remain optimistic about APDN's prospect. APDN has achieved strong financial performance and operational achievements in recent quarters as well as positive business developments. We believe top line growth will be further boosted in the coming quarters.

APDN's fundamentals remain strong. The Company's technology is unique and has competitive advantages over its peers. The Company is well positioned to boost its top line and bottom line in the coming quarters. According to our long term financial model, the Company's revenue will grow at a huge compound annual growth rate (CAGR) of 127% in the three fiscal years from 2012 to 2015. The Company will become profitable in fiscal 2015 with net income of $9.4 million or EPS of $0.01 per share.

We think the Company should trade around a P/E of 25x, which is lower than the average P/E multiple of the biotech industry. If we apply this P/E to our estimated EPS of $0.01 in fiscal 2015, discounted at 20% for 3 years, we get our price target of $0.18 per share. This values the company at $113 million in market

cap, which is reasonable in our view. As long as the Company can execute its growth strategy correctly, we believe value should be generated for investors.

But keep in Mind the Risks

Cash burn is our chief concern at this time.

As of June 30, 2012, the Company had only $1.3 million in cash and cash equivalents. Current cash can last one quarter. We believe APDN needs to tap the capital market very soon, and will do so on a regular basis.

We remind investors that any equity or convertible note financing will dilute the Company's current shareholder base and reduce its per share value. Actually, we have noticed that the Company's shares outstanding have increased dramatically from 135 million in fiscal 2007 to 627 million at the end of June of 2012. And we expect this trend will continue in the next few years when the Company continues to issue new shares or new convertible notes to fund its operations.

Another concern comes from APDN's revenue concentration. An aggregate of 59% of the Company's revenue was earned from two customers for the third quarter of 2012, while one customer accounted for 46% of the Company's total revenues for the nine months ending June 30, 2012.

PROJECTED INCOME STATEMENT

	2011A (Sep)					2012E (Sep)					2013E (SEP)	2014E (Sep)	2015E (Sep)
$ in million except per share data	Q1	Q2	Q3	Q4	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE
Total Revenues	**$0.32**	**$0.14**	**$0.23**	**$0.28**	**$0.97**	**$0.52**	**$0.52**	**$0.53**	**$0.54**	**$2.10**	**$5.50**	**$10.00**	**$24.50**
YOY Growth	*337.1%*	*-25.0%*	*35.0%*	*213.1%*	*86.3%*	*62.6%*	*269.1%*	*130.1%*	*90.6%*	*116.7%*	*162.0%*	*81.8%*	*145.0%*
CoGS	0.02	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.53	0.96	2.36
Gross Income	**0.30**	**0.13**	**0.23**	**0.28**	**0.97**	**0.52**	**0.52**	**0.53**	**0.54**	**2.10**	**4.97**	**9.04**	**22.14**
Gross Margin	*93.6%*	*89.9%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*90.4%*	*90.4%*	*90.4%*
SG&A	$1.3	$1.6	$1.6	$3.9	$8.4	$2.2	$1.8	$1.8	$1.8	$7.5	$8.5	$9.0	$11.0
% SG&A	*411.9%*	*1143.0%*	*688.2%*	*1387.3%*	*866.0%*	*416.4%*	*352.0%*	*331.6%*	*336.4%*	*358.7%*	*154.5%*	*90.0%*	*44.9%*
R&D	$0.02	$0.09	$0.05	$0.11	$0.27	$0.08	$0.10	$0.10	$0.10	$0.37	$0.35	$0.37	$0.40
% R&D	*6.5%*	*66.2%*	*20.9%*	*38.2%*	*27.8%*	*15.2%*	*18.5%*	*18.9%*	*18.7%*	*17.8%*	*6.4%*	*3.7%*	*1.6%*
Other	$0.1	$0.1	$0.1	$0.1	$0.4	$0.1	$0.1	$0.1	$0.1	$0.4	$0.4	$0.4	$0.3
% Other	*29.2%*	*65.4%*	*40.0%*	*32.4%*	*37.9%*	*19.0%*	*19.0%*	*19.6%*	*18.7%*	*19.1%*	*7.3%*	*4.0%*	*1.2%*
Operating Income	**($1.1)**	**($1.7)**	**($1.5)**	**($3.8)**	**($8.1)**	**($1.8)**	**($1.5)**	**($1.4)**	**($1.5)**	**($6.2)**	**($4.3)**	**($0.7)**	**$10.4**
Operating Margin	*-354.0%*	*-1184.6%*	*-649.1%*	*-1357.9%*	*-835.3%*	*-350.6%*	*-289.6%*	*-270.0%*	*-273.8%*	*-295.7%*	*-77.8%*	*-7.3%*	*42.6%*
Other Net	($0.2)	($0.9)	($0.7)	($0.6)	($2.5)	($0.6)	($0.1)	($0.0)	($0.1)	($0.7)	($1.0)	($1.0)	($1.0)
Pre-Tax Income	**($1.3)**	**($2.6)**	**($2.2)**	**($4.5)**	**($10.5)**	**($2.4)**	**($1.6)**	**($1.4)**	**($1.5)**	**($6.9)**	**($5.3)**	**($1.7)**	**$9.4**
Income taxes(benefit)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Tax Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Reported Net Income	**($1.3)**	**($2.6)**	**($2.2)**	**($4.5)**	**($10.5)**	**($2.4)**	**($1.6)**	**($1.4)**	**($1.5)**	**($6.9)**	**($5.3)**	**($1.7)**	**$9.4**
YOY Growth	-	-	-	-	-	-	-	-	-	-	*-23.8%*	*-67.2%*	*-644.5%*
Net Margin	*-422.9%*	*-1850.3%*	*-938.1%*	*-1586.1%*	*-1089.1%*	*-466.2%*	*-301.1%*	*-270.5%*	*-285.0%*	*-330.0%*	*-96.0%*	*-17.3%*	*38.5%*
Shares Out	*349.2*	*351.4*	*352.0*	*455.0*	*376.9*	*490.3*	*583.6*	*594.9*	*627.0*	*574.0*	*650.0*	*700.0*	*750.0*
Reported EPS	**($0.00)**	**($0.01)**	**($0.01)**	**($0.01)**	**($0.03)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.01)**	**($0.01)**	**($0.00)**	**$0.01**
YOY Growth	-	-	-	-	-	-	-	-	-	-	*-32.7%*	*-69.5%*	*-608.2%*
One time charge	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*
Non GAAP Net Income	**($1.3)**	**($2.6)**	**($2.2)**	**($4.5)**	**($10.5)**	**($2.4)**	**($1.6)**	**($1.4)**	**($1.5)**	**($6.9)**	**($5.3)**	**($1.7)**	**$9.4**
Non GAAP EPS	**($0.00)**	**($0.01)**	**($0.01)**	**($0.01)**	**($0.03)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.01)**	**($0.01)**	**($0.00)**	**$0.01**

Source: Company filing and Zacks Investment Research estimates

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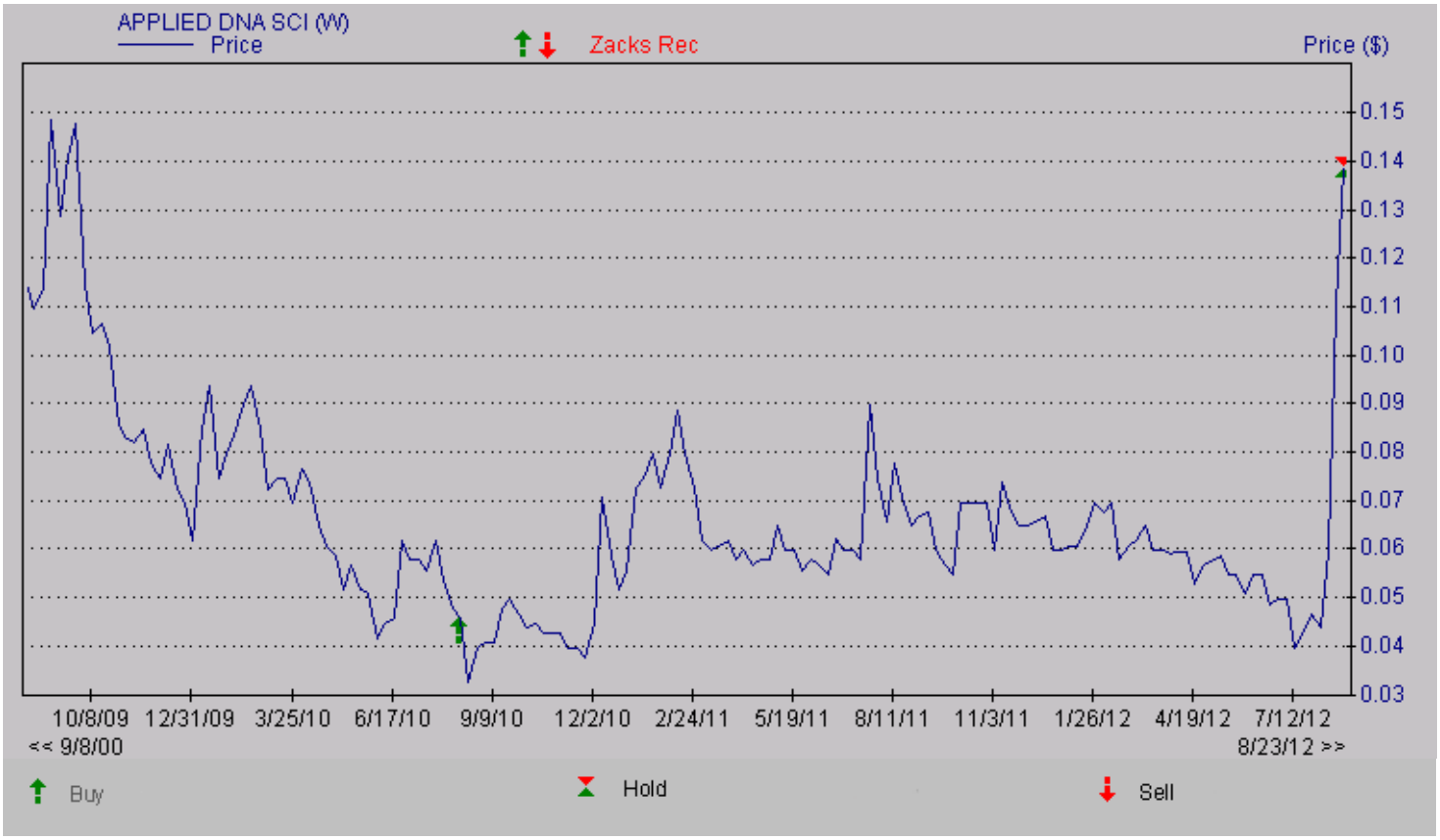
HISTORICAL ZACKS RECOMMENDATIONS



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