Zacks Small-Cap Research

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Applied DNA Sciences (APDN-OTC)

APDN: Record revenue reported for fiscal 3Q14 and first nine months of 2014, businesses continue to grow--Outperform

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	08/21/2013
Current Price (08/13/14)	$0.11
Twelve- Month Target Price	**$0.25**

OUTLOOK

We are optimistic about the Company's unique technology and two principle anti-counterfeiting and product authentication solutions: SigNature DNA and fiberTyping, 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 grow in the coming years.

APDN reported record revenue for fiscal 3Q14 and first nine months of fiscal 2014. We expect to see further growth of revenue in fiscal 4Q14 and beyond.

SUMMARY DATA

52-Week High	**$0.26**
52-Week Low	**$0.09**
One-Year Return (%)	**-36.05**
Beta	**2.06**
Average Daily Volume (sh)	**1,129,555**
Shares Outstanding (mil)	**827**
Market Capitalization ($mil)	**$91**
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)
2013	0.32 A	0.34 A	0.64 A	0.73 A	2.04 A
2014	0.60 A	0.64 A	0.84 A	0.95 E	3.03 E
2015					4.50 E
2016					10.00 E

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

	Q1 (Dec)	Q2 (Mar)	Q3 (Jun)	Q4 (Sep)	Year (Sep)
2013	-$0.00 A	-$0.00 A	-$0.00 A	-$0.00 A	-$0.02 A
2014	-$0.00 A	-$0.00 A	-$0.00 A	-$0.00 E	-$0.01 E
2015					-$0.01 E
2016					-$0.00 E

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

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WHAT'S NEW

- Record revenue reported for fiscal third quarter and first nine months;
- We increase our revenue estimates for fiscal fourth quarter and fiscal 2014;
- Business continues to grow;
- Maintain Outperform rating for APDN shares;

Record Revenue Reported for Fiscal Third Quarter 2014

On Aug 12, 2014, Applied DNA Sciences announced results of its third quarter and first nine months of fiscal 2014 ended June 30, 2014.

Total revenue for the third quarter of fiscal 2014 was $841,197, the **highest revenues** reported in the history of the Company. This represents a 31% increase year over year and a 32% increase sequentially. Third quarter revenue also beat our estimate of $0.75 million.

The increase was the results of increased sales of the company's DNAnet® and SigNature®DNA products and others within its cash-in-transit market.

Total operating expenses were $3.3 million for the fiscal third quarter of 2014, as compared to $3.5 million for the fiscal third quarter of 2013, a decrease of $159,869 or 5%. The decrease was primarily attributable to a reduction in stock-based compensation and consulting fees. This decrease was partially offset by an increase in payroll, as well as an increase in research and development expenses.

Net loss for the three months ended June 30, 2014 was $1.9 million ($0.00 per share), as compared to $2.1 million ($0.00 per share) for the three months ended June 30, 2013.

For the first nine months of this fiscal year, the Company generated approximately $2.1 million in revenue, more than the total revenues for any previous entire fiscal year. This reflects an increase of 59% from the same period last fiscal year.

Net loss for the nine months ended June 30, 2014 decreased to $11.0 million from a net loss of $14.0 million for the nine months ended June 30, 2013.

As of June 30, 2014, Applied DNA had $2.0 in cash.

In July 2014, APDN was awarded by the Missile Defense Agency a research project that would expand APDN's technology platform established in the Phase I Small Business Innovation Research (SBIR) contract to accommodate as many as 100 electronic component manufacturers. The contract provides for monthly payments to APDN totaling approximately $975,000 over a two year period.

According to our model, the Company's current cash balance along with its current customer base, projected cash flow and the minimum projected revenues for this remaining fiscal year will allow the company to have sufficient capital resources to meet projected cash flow requirements for the **next twelve months.**

We Increase Our Revenue Estimate for Fiscal Fourth Quarter and Fiscal 2014

We think fiscal third quarter was another strong quarter for APDN in terms of financial performance. APDN reported highest quarterly sales in the Company's history.

We think SG&A expenses will stabilize going forward since the Company has completed the move into new facility. Actually, SG&A expense declined to $2.9 million for 3Q14 from $3.8 million for the 1Q14, a

decrease of 23%. APDN is positioned to deliver against high demand while continuing necessary product development without additional major expenditures.

In April, 2014, APDN and a provider of **polyolefins** signed a term sheet for mutual development and cooperation regarding the supply of markers - and related additives - for polyolefin products. With this agreement, APDN has the opportunity to enter a market for a vital industrial material with estimated production of 140 billion kg per year. The cooperation between the parties will explore and test the feasibility of the project. The contract provides for initial payments to APDN, comprised of development and exclusivity fees. The payment of further installments is dependent on achieving specific performance goals over a defined period of less than one year.

The Company is applying SigNature(R) DNA on a greater scale than it has in the past, expanding the universe of DNA-marked products, which in turn should increase the demand for authentications. The individual size of the Company's customers is also growing with multiple customers having revenues from $3 billion to $30 billion annually.

Therefore we expect continued revenue growth and bottom line improvement in the coming quarters. Specifically, we increased our revenue estimate for fiscal 4Q14 to $0.95 million from previous $0.75 million. As a result, we increase our revenue estimate for fiscal 2014 to $3.03 million from previous $2.83 million. This represents the first time, annual revenue will cross the mark of $3 million in the company's history.

Business Continues to Grow

In July, APDN was awarded a $975,000 contract with the Missile Defense Agency's Small Business Innovation Research program, which provides the Company funding to develop larger-scale and more efficient methods of SigNature® DNA application and authentication. This includes the development of an optical reader that could be employed in the field for rapid detection of the SigNature DNA ink marked on a component. The intended outcome is a capacity to service 100 additional customers.

In July, APDN also signed an agreement with **Wakefield Inspection Services** for a collaboration to provide global supply chain, traceability and security-driven solutions to customers using SigNature® T DNA marking and DNA authentication services. Operating in over 60 countries around the world, WIS is a trusted industry leader in the textile business for providing independent quality assessments and inspections with incomparable standards for accurate, objective and quality verification and reporting services. This collaboration will pave the way for Applied DNA Sciences to become an integral part of the entire textile industry. This agreement has the potential to open numerous opportunities for APDN as SigNature®T is developed for authentication at all points in the supply chain, from raw materials to finished products.

In May, APDN signed a joint development agreement with **Pillar Technologies**, a business unit of ITW. This agreement is anticipated to bring APDN's technology platform to existing and future Pillar customers across multiple verticals including textiles and packaging.

In May 2014, the U.S. House of Representatives Senate Armed Services Committee added language to the National Defense Authorization Act (NDAA) for Fiscal Year 2015 calling on the Department of Defense for an update on DNA marking of microelectronics, among other counterfeit detection efforts.

In May 2014, the federal government officially implemented new federal regulations requiring anti-counterfeiting systems for electronics suppliers to the Department of Defense on May 6, 2014. The regulations enforce laws passed in 2012 and 2013.

In May 2014, NASA's Jet Propulsion Laboratory (JPL) has received training on DNA authentication as part of its effort to assess the latest ideas and technologies related to counterfeit risk mitigation. JPL also intends to include information about SigNature DNA marking, including the CPA Program, as part of its

Counterfeit Awareness Training Program. The latter has the participation of all major NASA facilities and many of its largest suppliers.

In May, 2014, APDN announced a partnership with Intelligent Product Solutions (IPS), an end-to-end product design and development services provider. The partnership involves the co-development of various products that broaden the means of authenticity assurance for APDN's clients and their customers. The outcome will be increased quality control and fraud detection for marked products.

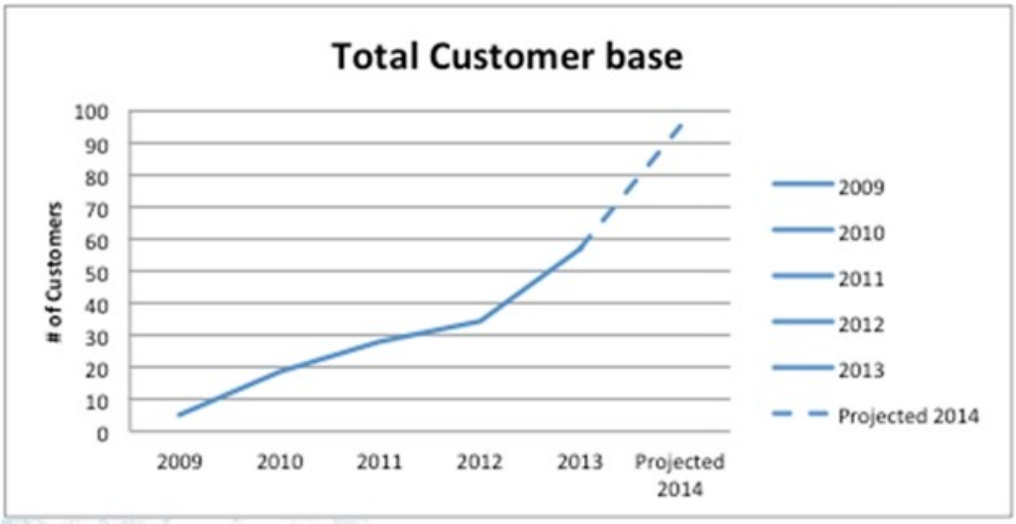
We are pleased to see that APDN's sales pipeline and its customer base continue to grow. We believe these new contracts and partnerships are laying the foundation for continued growth for Applied DNA Sciences. With a strong infrastructure in place and an experienced team of employees and management, APDN is delivering against stronger demands.

APDN Shares Are Undervalued

We maintain our Outperform rating for APDN shares and reiterate our 12-month price target of $0.25 per share.

We are impressed by the strong financial performance for the fiscal third quarter and the first nine months of the year. Revenue increased 31% for the fiscal 3Q14 and 59% for the first ninth months of fiscal 2014, respectively, which represented the highest third quarter and first nine month revenue ever in the Company's history.

Customer base has increased greatly from fiscal 2009 to present.



We remain optimistic about APDN's prospect. 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 years. According to our long term financial model, the Company's revenue will grow at a compound annual growth rate (CAGR) of 61% in the next 6 fiscal years from 2014 to 2020. The Company will become profitable in fiscal 2018 with net income of $2.0 million or EPS of $0.00 per share.

APDN is a high growth company. In terms of valuation, we think a P/E of 45x is appropriate for the Company. We apply a P/E of 45x to our estimated EPS of $0.01 in fiscal 2020, discounted at 20% for 5 years, we get our price target of $0.25 per share. This values the company at about $207 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 shareholders.

But Cash burn is still our chief concern at this time.

Since APDN will become profitable in fiscal 2018, the Company still needs to raise funds for its operation until positive cash flow can be generated in 2017. We remind investors that any equity or convertible note financing will dilute the Company's current shareholder base and reduce its per share value.

PROJECTED INCOME STATEMENT

	2013E (SEP)					2014E (Sep)					2015E (Sep)	2016E (Sep)	2017E (Sep)	2018E (Sep)	2019E (Sep)	2020E (Sep)
$ in million except per share data	Q1	Q2	Q3	Q4	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE	FYE	FYE	FYE
Total Revenues	**$0.32**	**$0.34**	**$0.64**	**$0.73**	**$2.04**	**$0.60**	**$0.64**	**$0.84**	**$0.95**	**$3.03**	**$4.50**	**$10.00**	**$15.00**	**$20.00**	**$27.50**	**$35.00**
YOY Growth	*-38.5%*	*-33.5%*	*22.0%*	*150.7%*	*9.8%*	*88.0%*	*84.9%*	*30.5%*	*30.3%*	*48.6%*	*48.7%*	*122.2%*	*50.0%*	*33.3%*	*37.5%*	*27.3%*
CoGS	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	0.00	0.00	0.00
Gross Income	**0.32**	**0.34**	**0.64**	**0.73**	**2.04**	**0.60**	**0.64**	**0.84**	**0.95**	**3.03**	**4.50**	**10.00**	**15.00**	**20.00**	**27.50**	**35.00**
Gross Margin	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*
SG&A	$2.5	$2.8	$3.2	$2.7	$11.2	$3.8	$3.3	$2.9	$2.8	$12.9	$13.5	$14.0	$15.0	$16.0	$17.5	$18.5
% SG&A	*793.6%*	*799.3%*	*502.6%*	*367.9%*	*550.0%*	*643.8%*	*517.6%*	*350.5%*	*294.7%*	*426.1%*	*300.0%*	*140.0%*	*100.0%*	*80.0%*	*63.6%*	*52.9%*
R&D	$0.15	$0.18	$0.18	$0.18	$0.69	$0.46	$0.36	$0.27	$0.30	$1.39	$1.45	$1.50	$1.65	$1.70	$1.80	$1.95
% R&D	*46.5%*	*51.2%*	*28.7%*	*25.1%*	*34.0%*	*76.9%*	*56.5%*	*31.7%*	*31.6%*	*45.8%*	*32.2%*	*15.0%*	*11.0%*	*8.5%*	*6.5%*	*5.6%*
Other	$0.0	$0.0	$0.1	$0.2	$0.3	$0.1	$0.1	$0.1	$0.1	$0.4	$0.3	$0.3	$0.3	$0.3	$0.3	$0.3
% Other	*6.6%*	*6.3%*	*9.7%*	*29.6%*	*15.8%*	*17.6%*	*16.8%*	*13.5%*	*10.5%*	*14.1%*	*6.7%*	*3.0%*	*2.0%*	*1.5%*	*1.1%*	*0.9%*
Operating Income	**($2.4)**	**($2.6)**	**($2.8)**	**($2.4)**	**($10.2)**	**($3.8)**	**($3.1)**	**($2.5)**	**($2.3)**	**($11.7)**	**($10.8)**	**($5.8)**	**($2.0)**	**$2.0**	**$7.9**	**$14.3**
Operating Margin	*-746.7%*	*-756.8%*	*-440.9%*	*-322.6%*	*-499.7%*	*-638.3%*	*-490.8%*	*-295.7%*	*-236.8%*	*-385.9%*	*-238.9%*	*-58.0%*	*-13.0%*	*10.0%*	*28.7%*	*40.7%*
Other Net	($6.3)	($0.5)	$0.7	($1.4)	($7.5)	($2.5)	$0.4	$0.6	($0.3)	($1.8)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pre-Tax Income	**($8.7)**	**($3.1)**	**($2.1)**	**($3.7)**	**($17.7)**	**($6.3)**	**($2.8)**	**($1.9)**	**($2.5)**	**($13.5)**	**($10.8)**	**($5.8)**	**($2.0)**	**$2.0**	**$7.9**	**$14.3**
Income taxes(benefit)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$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%*	*0.0%*	*0.0%*	*0.0%*
Reported Net Income	**($8.7)**	**($3.1)**	**($2.1)**	**($3.7)**	**($17.7)**	**($6.3)**	**($2.8)**	**($1.9)**	**($2.5)**	**($13.5)**	**($10.8)**	**($5.8)**	**($2.0)**	**$2.0**	**$7.9**	**$14.3**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	-	*-66.38%*	*-202.56%*	*295.00%*	*80.38%*
Net Margin	*-2740.2%*	*-907.6%*	*-331.2%*	*-510.0%*	*-868.6%*	-	-	-	-	-	-	-	*-13.0%*	*10.0%*	*28.7%*	*40.7%*
Shares Out	*649.9*	*680.4*	*721.1*	*763.9*	*703.9*	*789.9*	*808.2*	*814.1*	*825.0*	*809.3*	*865.0*	*915.0*	*965.0*	*1015.0*	*1050.0*	*1070.0*
Reported EPS	**($0.01)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.03)**	**($0.01)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.02)**	**($0.01)**	**($0.01)**	**($0.00)**	**$0.00**	**$0.01**	**$0.01**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	-	*-68.1%*	*-197.5%*	*281.8%*	*77.0%*
One time charge	*$6.33*	*$0.00*	*$0.00*	*$0.00*	*$6.33*	*$2.63*	*$0.00*	*$0.00*	*$0.00*	*$2.63*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*
Non GAAP Net Income	**($2.4)**	**($3.1)**	**($2.1)**	**($3.7)**	**($11.4)**	**($3.7)**	**($2.8)**	**($1.9)**	**($2.5)**	**($10.8)**	**($10.8)**	**($5.8)**	**($2.0)**	**$2.0**	**$7.9**	**$14.3**
Non GAAP EPS	**($0.00)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.02)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.01)**	**($0.01)**	**($0.01)**	**($0.00)**	**$0.00**	**$0.01**	**$0.01**

Source: Company filing and Zacks Investment Research estimates

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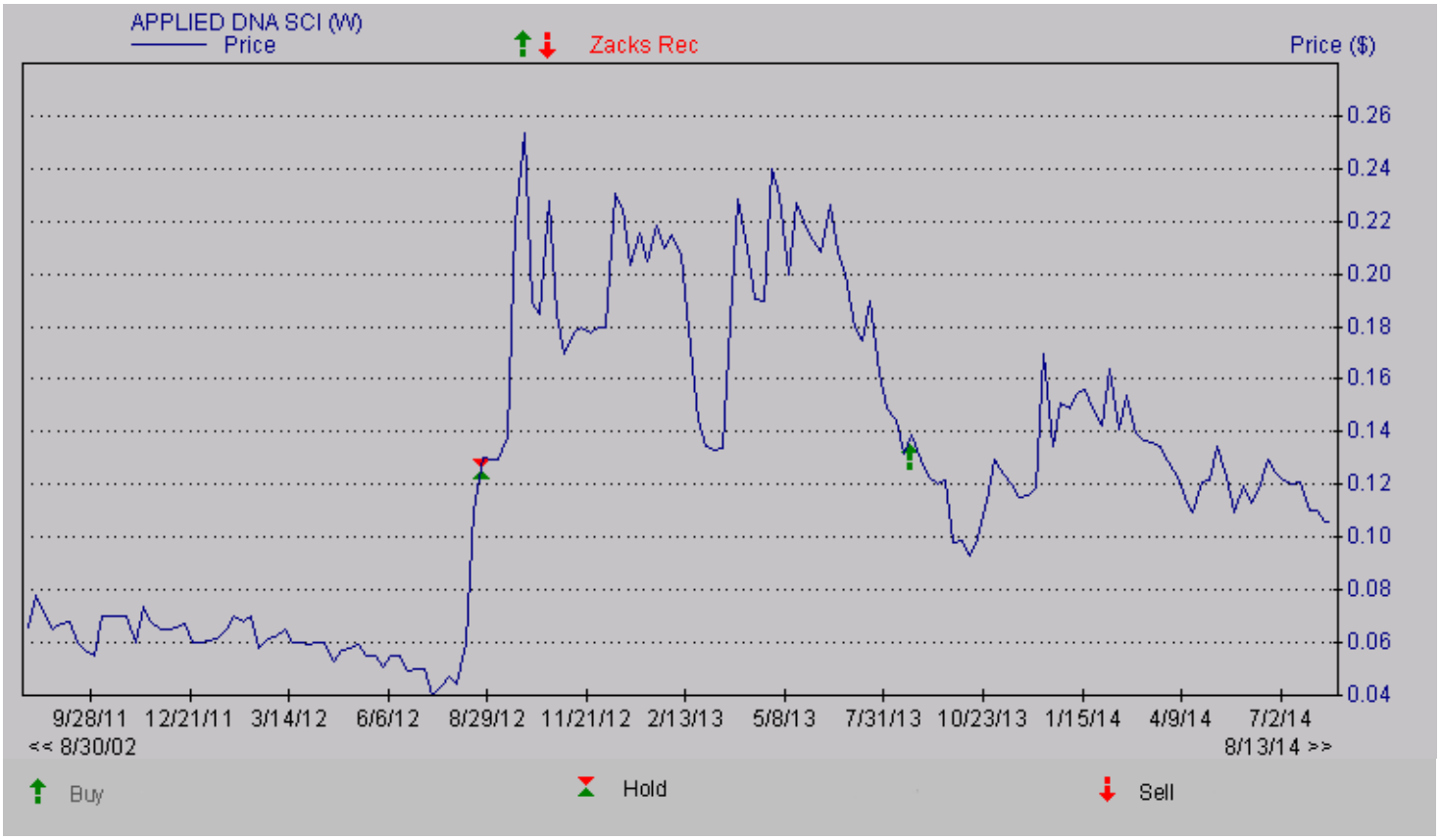

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Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters.
Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

The current distribution is as follows: Buy/Outperform- 16.7%, Hold/Neutral- 75.9%, Sell/Underperform – 6.5%. Data is as of midnight on the business day immediately prior to this publication.