Zacks Small-Cap Research

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Applied DNA Sciences (APDN-OTC)

APDN: First fiscal quarter financials were disappointing, but revenue growth will resume in second half of the fiscal year---Neutral

Current Recommendation	**Neutral**
Prior Recommendation	Outperform
Date of Last Change	08/23/2012
Current Price (02/21/13)	$0.13
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 grow in the coming years.

Revenue will resume growth in second half of the year though first quarter financials were disappointing,

SUMMARY DATA

52-Week High	**$0.29**
52-Week Low	**$0.04**
One-Year Return (%)	**131.13**
Beta	**1.42**
Average Daily Volume (sh)	**1,560,408**
Shares Outstanding (mil)	**657**
Market Capitalization ($mil)	**$99**
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	0.29 A	1.85 A
2013	0.32 A	0.52 E	0.75 E	0.92 E	2.51 E
2014					5.50 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 A	-$0.01 A
2013	-$0.00 A	-$0.00 E	-$0.00 E	-$0.00 E	-$0.01 E
2014					-$0.01 E

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

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WHAT'S NEW

First Quarter Financials Disappointing, but Top Line Growth Should Resume in 2H13

On February 14, 2013, Applied DNA Sciences (APDN) reported financial results for the first fiscal quarter of 2013 ending December 31, 2012.

For the fiscal 1Q13 ended December 31, 2012, APDN generated $317,670 in revenues from operations compared to $516,904 for the three months ended December 31, 2011, a 38.5% decline. The decrease in sales was primarily caused by the expiration of certain contracts and delays in transition to new contracts with products in target markets.

SG&A expenses were $2.5 million for the three months ended December 31, 2012, compared to $2.2 million for the three months ended December 31, 2011. The increase of $368,739, or 17.1%, is primarily attributable to higher professional and service fees incurred.

Research and development expenses increased from $78,473 for the three months ended December 31, 2011 to $147,666 for the three months ended December 31, 2012. The increase of $69,193 is attributable to additional research and development activity needed with current operations.

Total operating expenses for the three months ended December 31, 2012 were $2.7 million, compared to $2.4 million for the three months ended December 31, 2011, an increase of $360,554 which was primarily attributable to an increase in professional fees paid and in R&D expenditures.

GAAP net loss for the three months ended December 31, 2012 increased to $8,704,757 or $0.01 per share from a net loss of $2,409,905 or $0.00 per share for the three months ended December 31, 2011 primarily attributable to the factors described above.

Non-GAAP net loss was $2.4 million or $0.00 per share for the three months ended December 31, 2012, compared to $2.4 million or $0.00 per share for the three months ended December 31, 2011.

Apparently, revenue for the fiscal first quarter was disappointing to investors, but we believe revenue growth will accelerate in the second half of the fiscal year of 2013. We believe the Company has spent the time and resources to lay the foundation on which to properly build its business.

Business continues to grow in the past few months. New technology breakthroughs during the quarter strengthen the Company's position in verticals such as textiles and in optical reading (scanning). Meanwhile, contract with military electronics offering continues to have strong momentum.

APDN opened new cash-in-transit business in Sweden for the Company's anti-theft product, smartDNA, in that country. A new patent was awarded for the APDN's linkage of SigNature® DNA marks to optical reporting (scanners), while new breakthroughs in SigNature DNA marking for textiles strengthen the Company's offerings in the vertical.

In the military electronics area, APDN built new contractual relationships with firms that will provide third-party SigNature DNA marking on electronics, including in this effort the first test house in the program, Premier Semiconductor. The Company also pointed to expansion of its capacity in volume and speed in the authentication process, and hiring of new personnel in sales, scientific, and quality areas.

Based on all these developments, we model the Company's top line will resume growth in the second half of this fiscal year. Total revenue for fiscal 2013 will reach the mark of $2 million.

Balance Sheet Boosted by Recent Financing

On January 10, 2013, APDN closed on an additional $5.5 million (second closing) financing, bringing the total amount of financing to $7.5 million with institutional accredited investor, **Crede CG II, Ltd**.

In November 2012, the Company closed on the initial $2 million in financing with Crede for restricted common stock priced at $0.186/share.

The additional $5,500,000 was invested by Crede in convertible preferred stock of the Company. The closing, on January 7, 2013, was at $1,000 per share of preferred stock which was subsequently fully converted into 25,462,963 shares of common stock by the Company on January 8, 2013 at a conversion price of $0.216/share.

Series C Warrants to purchase 26,881,720 shares of Common Stock become exercisable for six months after the eleventh trading day following the second closing. It is the Company's intention to exercise its right to repurchase these Series C Warrants for $50,000 at the close of trading on the tenth trading day following the second closing.

The investor is limited to 9.9% ownership at any given point in time. The investor is in a "passive" position and will not occupy a Board position.

APDN intends to use the additional capital to take advantage of developments in its business verticals in recent months, including in electronics, textiles, and anti-theft products. The company has already expanded its plant and staff in order to accommodate this progression, and aims to continue and broaden that expansion.

This financing comes at an excellent time. It greatly boosted balance sheet of the Company.

Further, on Dec 20, 2012, APDN was named a recipient of an Empire State Development Corporation (ESDC) Consolidated Funding Application (CFA) Round II grant award. Applied DNA Sciences was awarded $229,957 for their "Rapid Growth and Expansion Project." This money will be used to purchase new laboratory equipment to complement the new hires necessary for the rapid growth project. This new equipment will enhance the company's DNA formulation menu especially in defense and law enforcement applications.

As of December 31, 2012, APDN had $0.98 million in cash. With the proceeds from the financing, the Company should have cash at the neighborhood of $4.5 million at the end of March, 2013. Current cash can last into 1Q14.

APDN is at a crucial stage in the development of Applied DNA Sciences. Access to this capital enhances its capacity to respond to growth opportunities.

Sustainable Growth is Supported by Continued New Business Developments

In the past few months, APDN has taken more steps concerning its SigNature DNA marking and authentication platform and bolstering its plant and staff. The Company continues to make great progress in business development. Personnel have been added, and plant capacity has been increased by over 50%. We believe APDN can stand ready to respond to all industry inquiries.

Following are the major business developments in the past few months.

On Feb 15, 2013, APDN announced the activation of an agreement with the **Defense Logistics Agency** (DLA) for authentication services and training. Signed in November, the contract was activated with the delivery of the first services by APDN to DLA.

Authentication services and training, consisting of forensic analysis of DLA-procured parts with SigNature DNA marks, are in support of the DLA mandate requiring the use of SigNature DNA on microcircuits provided by trusted suppliers to DLA.

The year-long contract, with a maximum value of $150,000, represents APDN's first direct business with a federal U.S. government agency. APDN has participated in a two-phase pilot for DLA (generating about $1 million in total), however, that work was subcontracted through LMI, a not-for-profit consultancy which works with DLA.

The current mandate requiring SigNature DNA marking on microcircuits delivers to DLA the ability to check for parts authenticity or provenance. This contract enables DLA to have APDN forensically authenticate the DNA marked components.

On January 17, 2013, APDN announced that **Forward Components, Inc**. has requested a unique DNA mark from APDN for DNA-marking for FSC 5962 microcircuits in accordance with the mandate issued by the U.S. Defense Logistics Agency (DLA). The mandate requires use of APDN's SigNature® DNA marking on a certain class of microcircuits, FSC 5962.

FCE will be required to undergo an in-house inspection and training prior to receiving the unique DNA mark to determine if they will qualify to mark in-house or will require third party marking initially. Quality control testing is an ongoing requirement to ensure that all parts continue to be marked correctly for as long as FCE marks parts with a unique APDN DNA marker.

FCE is an authorized distributor and assembly/test facility for the military and aerospace hi-rel industries. The company will apply their SigNature DNA Provenance mark to electronic parts which have traceable documentation as well as parts known as non-trace legacy components. The latter, which comprise only about 5% of the business of FCE, are parts which lack traceability documentation, but which are subject to rigorous test and inspection methods at the FCE facility. These parts, sometimes called "obsolete," can be vital to many military applications due to the long life of much military equipment.

The Provenance mark to be used by FCE is one of two forms of APDN's SigNature DNA mark: the SigNature Authenticity mark, which is intended to authenticate original products manufactured by OCMs, and the SigNature Provenance mark for distributed products that are marked after manufacture.

On Jan 14, 2013, APDN announced that **Premier Semiconductor Services**, LLC has agreed in principle to provide DNA-marking services for electronics firms wishing to comply with APDN's SigNature® DNA authentication platform. The framework of the agreement allows for the platform to be available through Premier to authorized distributors, to manufacturers including members of the Semiconductor Industry Association (SIA), and all others who may benefit from a fast-track route to SigNature DNA marking, whereby Premier acts as subcontractor.

SigNature DNA marking is required by the Defense Logistics Agency (DLA) for use on certain electronic parts provided to the Agency. APDN will serve as the prime contractor for SigNature DNA marking, and subcontract as necessary. In response to a DLA mandate which came into effect on November 15, 2012, electronics components in FSC Class 5962 supplied to the Agency are required to use SigNature DNA marking.

Third party marking allows for a turnkey solution to immediate SigNature DNA marking capability, where ease of logistics is the main concern. Premier is the second company to announce SigNature DNA-marking as a "third party" service under license from Applied DNA Sciences. SMT, of Sandy Hook, Connecticut, announced its third party SigNature DNA-marking services on November 30, 2012.

Premier provides one of the most comprehensive offerings of both final manufacturing and IC testing services in North America. They are a privately held entity with four locations located across the country

that service a very diversified array of clients that include OCMs, OEMs, CMs, and distributors in commercial, automotive, military, aerospace, medical, and industrial market segments.

On Dec 21, 2012, APDN announced that the **UK Metropolitan Police Service** (MPS) will be using its proprietary DNANet™ property marking kits as part of a major initiative to reduce crime in targeted London neighborhoods.

MPS will be deploying DNANet markers in thousands of homes where homeowners will be encouraged to mark and register their valuable belongings. In the case of theft, the presence of the unique DNANet marker enables police to identify stolen goods and trace them to a specific crime scene. The unequaled forensic merit of DNANet markers empower municipalities to apprehend and convict criminals. In the long term, crime deterrence rises from enhanced policing and prosecution power. Street and home signage announcing the use of DNANet markers will place potential offenders on alert, offering additional deterrence value.

The value of DNA-based law enforcement tool offered by Applied DNA Sciences, is well known in the United Kingdom. Recently, Applied DNA Sciences was awarded the Excellence in Policing award and POP ("Problem Oriented Policing") award. These awards recognized APDN's SigNature® DNA technology which helped the Lancashire constabulary to positively identify and prosecute perpetrators in the UK. In December 2011, APDN was awarded the coveted Tilley award from both Houses of Parliament for the contribution of SigNature DNA in the resolution of the Blackburn robbery case that resulted in five convictions with a total of 55 years in sentencing. In a separate case, SigNature DNA helped in the dismantling of a major UK drug ring where eleven cartel members were sentenced to a total of 31 years in prison.

On Dec 13, 2012, APDN announced that its evidentiary smartDNA platform has been adopted by **Vattenfall Eldistribution AB** to protect copper assets located in Energy stations throughout Sweden. This will be implemented by the end of December 2012. Vattenfall in Sweden accounts for 50% of Sweden's electricity, with over 900,000 customers. It is the nation's largest regional and local service provider.

The forensic precision and robustness of the smartDNA platform has been proven to help with linking criminals to crimes in Sweden. The purpose of this application for copper is a natural extension of the program that has been officially recognized by the Swedish National Police, and enforced by all police forces throughout Sweden who have been fully trained on the smartDNA system.

In the United States, it is estimated that more than 95% of energy utilities experienced copper theft in the past 12 months with over 50,000 incidences nationwide. Nearly 8,000 of these thefts took place for energized copper resulting in an estimated 35 fatalities.

On Dec 10, 2012, APDN announced that its evidentiary DNA platform has been adopted in Sweden for use in helping protect cash in transit in that country. The security company **Nokas AS** revealed that APDN's marking and authentication platform will first be deployed in armored vehicles in the Stockholm area and then expanded to the company's entire fleet.

Nokas, based in Norway, fields a fleet of over 250 armored trucks to transport cash. It is one of only two cash transport companies in Sweden servicing many retail chains, large banks and other institutions.

The APDN platform for cash in transit already has been used with great success in the United Kingdom, where DNA evidence has helped in over fifty convictions of armed and dangerous criminals since 2009, in an environment where front-line police and private guards are typically unarmed. The DNA marking and authentication platform protects more than 26% of cash being transported to and from banks in the United Kingdom.

Elsewhere in Sweden, adoption of the APDN DNA platform has been expanding.

- APDN's anti-intrusion spray technology has now been installed in over 42 jewelry stores in Sweden. It is required for use by the Scandinavian insurance company If.
- Earlier this year, the Swedish National Police Board (RPS) announced its decision to use the security technology in covert police operations nationwide in Sweden.

Both APDN products, as well as the cash-in-transit platform, are branded in Sweden as SmartDNA.

On Nov 29, 2012, APDN announced that it has signed multiple contracts in support of the mandate by the **Defense Logistics Agency** for use of APDN's SigNature® DNA marking and authentication technology.

These electronics companies have or will receive SigNature DNA and essential materials and services from APDN for DNA marking during or after manufacture. These steps will qualify them as SigNature DNA-compliant.

The contracts will enable electronics companies to fulfill the DLA mandate, announced on August 7 in a clause in Defense Logistics Acquisition Directive (DLAD) 52.211-9074, and expanded on November 7 with a provision at DLAD 52.211-9008. This mandate specifically requires SigNature DNA marking for procurements of items falling within Federal Supply Class 5962, Electronic Microcircuits. The requirement applies only to procurements made by DLA.

The developing list of participating defense contractors will enable the military electronics supply chain to move toward compliance with the anti-counterfeiting language in Section 818 of the National Defense Authorization Act for Fiscal Year 2012 (Section 818). A major deadline for Section 818, which imposes strict requirements for control of counterfeits, is due to be reached very soon. In a press announcement released on October 31, DLA pointed to the connection between the mandate and the coming implementation of NDAA Section 818:

The new requirement also facilitates the goals of Congress to protect DoD's supply chains and national cybersecurity, which Congress outlined in the 2012 National Defense Authorization Act. This requires DoD, as well as industry, to develop counterfeit item detection and prevention measures for electronic items.

DLA is initially targeting microelectronics, but the technology is used with other commodities commercially and has broad implications for other DLA products and equipment at risk for counterfeiting.

VALUATION AND RECOMMENDATION

We maintain our Neutral rating for APDN at this point, and reiterate our 12-month price target of $0.18 per share.

Apparently, first fiscal quarter financials were disappointing. Revenue for second fiscal quarter may still be flat. But we believe revenue will resume growth in the second half of this fiscal year due to the focused marketing efforts management has put in. Total revenue for fiscal 2013 will reach the mark of $2 million.

Business continues to grow in the last few months. Balances sheet has been boosted by recent financing. All this foundation will generate positive impact on the operations of the Company.

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 87% in the four fiscal years

from 2013 to 2017. The Company will break even in fiscal 2016, and become profitable in fiscal 2017 with net income of $8.5 million or EPS of $0.01 per share.

In terms of valuation, we think the Company should trade between a P/E of 30x. and 40x. We apply a P/E of 35x to our estimated EPS of $0.01 in fiscal 2017, discounted at 20% for 4 years, we get our price target of $0.18 per share. This values the company at about $120 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 Cash burn is still our chief concern at this time.

As of December 31, 2012, APDN had $0.98 million in cash. With the proceeds from the financing, the Company should have cash at the neighborhood of $4.5 million at the end of March, 2013. Current cash can last into 1Q14.

Since APDN will break even in fiscal 2016 and become profitable in fiscal 2017, 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. Actually, we have noticed that the Company's shares outstanding have increased dramatically from 135 million in fiscal 2007 to current 657 million at the end of December, 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.

PROJECTED INCOME STATEMENT

	2012A (Sep)					2013E (SEP)					2014E (Sep)	2015E (Sep)	2016E (Sep)	2017E (Sep)
$ in million except per share data	Q1	Q2	Q3	Q4	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE	FYE
Total Revenues	**$0.52**	**$0.52**	**$0.53**	**$0.29**	**$1.85**	**$0.32**	**$0.45**	**$0.55**	**$0.70**	**$2.02**	**$5.50**	**$12.50**	**$17.50**	**$25.00**
YOY Growth	*62.6%*	*269.1%*	*130.1%*	*3.6%*	*91.5%*	*-38.5%*	*-13.2%*	*4.1%*	*140.7%*	*8.8%*	*172.6%*	*127.3%*	*40.0%*	*42.9%*
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
Gross Income	**0.52**	**0.52**	**0.53**	**0.29**	**1.85**	**0.32**	**0.45**	**0.55**	**0.70**	**2.02**	**5.50**	**12.50**	**17.50**	**25.00**
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%*
SG&A	$2.2	$1.8	$1.8	$1.9	$7.6	$2.5	$2.3	$2.2	$2.0	$9.0	$10.4	$11.5	$12.5	$14.0
% SG&A	*416.4%*	*352.0%*	*331.6%*	*648.6%*	*410.6%*	*793.6%*	*511.1%*	*400.0%*	*285.7%*	*447.1%*	*189.1%*	*92.0%*	*71.4%*	*56.0%*
R&D	$0.08	$0.10	$0.10	$0.16	$0.43	$0.15	$0.15	$0.15	$0.15	$0.60	$0.75	$0.90	$1.10	$1.25
% R&D	*15.2%*	*18.5%*	*18.9%*	*54.4%*	*23.3%*	*46.5%*	*33.3%*	*27.3%*	*21.4%*	*29.6%*	*13.6%*	*7.2%*	*6.3%*	*5.0%*
Other	$0.1	$0.1	$0.1	$0.0	$0.3	$0.0	$0.1	$0.1	$0.1	$0.3	$0.4	$0.3	$0.3	$0.3
% Other	*19.0%*	*19.0%*	*19.6%*	*4.6%*	*16.9%*	*6.6%*	*22.2%*	*18.2%*	*14.3%*	*15.9%*	*7.3%*	*2.4%*	*1.7%*	*1.2%*
Operating Income	**($1.8)**	**($1.5)**	**($1.4)**	**($1.8)**	**($6.5)**	**($2.4)**	**($2.1)**	**($1.9)**	**($1.6)**	**($7.9)**	**($6.1)**	**($0.2)**	**$3.6**	**$9.5**
Operating Margin	*-350.6%*	*-289.6%*	*-270.0%*	*-607.6%*	*-350.9%*	*-746.7%*	*-466.7%*	*-345.5%*	*-221.4%*	*-392.6%*	*-110.0%*	*-1.6%*	*20.6%*	*37.8%*
Other Net	($0.6)	($0.1)	($0.0)	$0.0	($0.6)	($6.3)	$0.0	$0.0	$0.0	($6.3)	($1.0)	($1.0)	($1.0)	($1.0)
Pre-Tax Income	**($2.4)**	**($1.6)**	**($1.4)**	**($1.8)**	**($7.2)**	**($8.7)**	**($2.1)**	**($1.9)**	**($1.6)**	**($14.3)**	**($7.1)**	**($1.2)**	**$2.6**	**$8.5**
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
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%*
Reported Net Income	**($2.4)**	**($1.6)**	**($1.4)**	**($1.8)**	**($7.2)**	**($8.7)**	**($2.1)**	**($1.9)**	**($1.6)**	**($14.3)**	**($7.1)**	**($1.2)**	**$2.6**	**$8.5**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	-	-	*225.00%*
Net Margin	*-466.2%*	*-301.1%*	*-270.5%*	*-601.8%*	*-385.5%*	*-2740.2%*	*-466.7%*	*-345.5%*	*-221.4%*	*-706.5%*	*-128.2%*	*-9.6%*	*14.9%*	*33.8%*
Shares Out	*490.3*	*583.6*	*594.9*	*635.5*	*576.1*	*649.9*	*657.0*	*682.0*	*685.0*	*668.5*	*750.0*	*800.0*	*850.0*	*900.0*
Reported EPS	**($0.00)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.01)**	**($0.01)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.02)**	**($0.01)**	**($0.00)**	**$0.00**	**$0.01**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	-	-	*206.9%*
One time charge	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$6.33*	*$0.00*	*$0.00*	*$0.00*	*$6.33*	*$0.00*	*$0.00*	*$0.00*	*$0.00*
Non GAAP Net Income	**($2.4)**	**($1.6)**	**($1.4)**	**($1.8)**	**($7.2)**	**($2.4)**	**($2.1)**	**($1.9)**	**($1.6)**	**($7.9)**	**($7.1)**	**($1.2)**	**$2.6**	**$8.5**
Non GAAP EPS	**($0.00)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.01)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.01)**	**($0.01)**	**($0.00)**	**$0.00**	**$0.01**

Source: Company filing and Zacks Investment Research estimates

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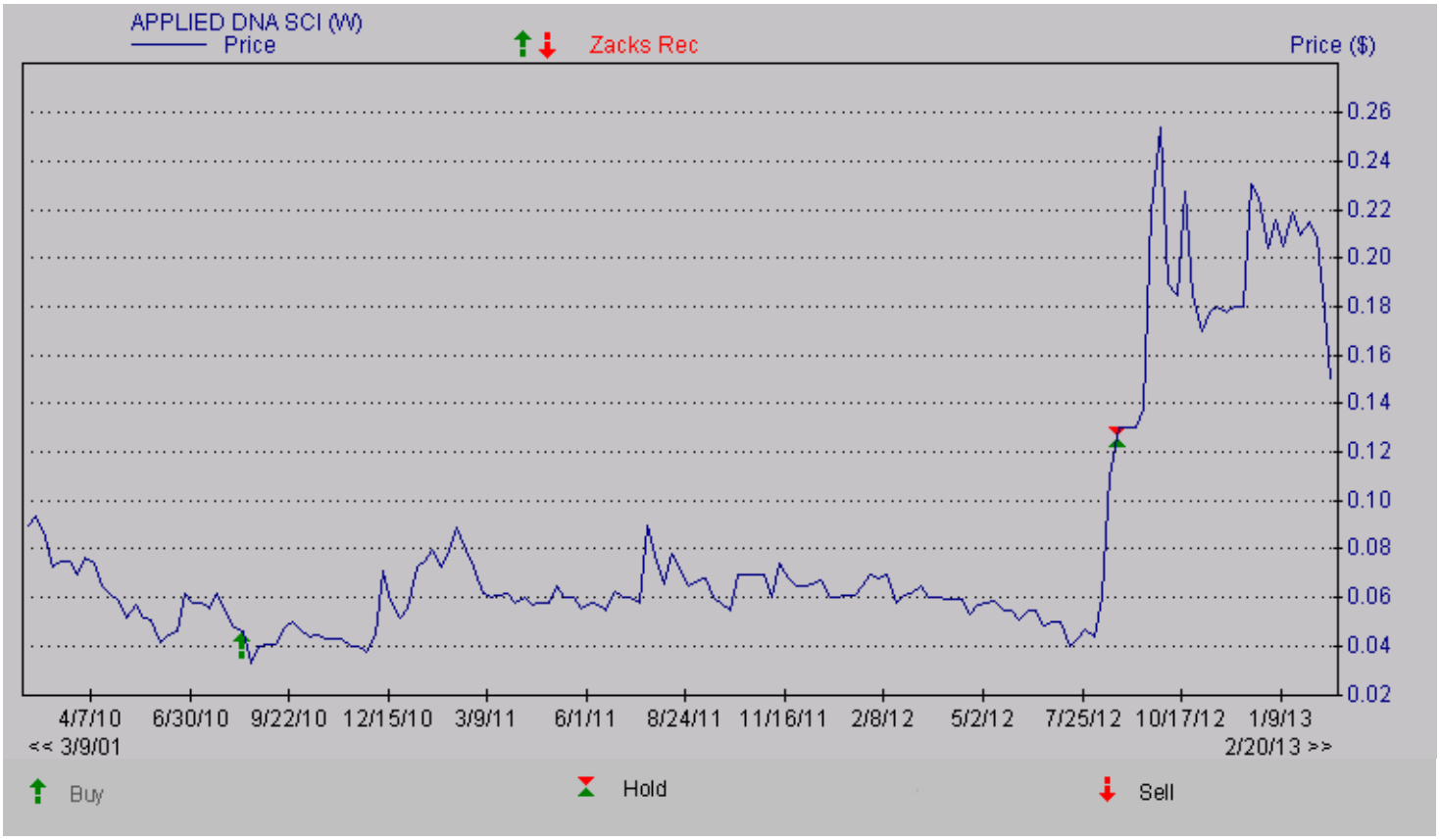
HISTORICAL ZACKS RECOMMENDATIONS



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