Zacks Small-Cap Research

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Applied DNA Sciences (APDN-OTC)

APDN: 2Q14 revenue increased by 85% yoy, highest revenue for second quarter in the company's history; businesses continue to grow--Outperform

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	08/21/2013
Current Price (05/12/14)	$0.13
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 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.

APDN reported 85% and 86% revenue increase in 2Q14 and 1H14 respectively. We expect to see further growth of revenue in fiscal 2014 and beyond.

SUMMARY DATA

52-Week High	**$0.26**
52-Week Low	**$0.09**
One-Year Return (%)	**-36.05**
Beta	**2.06**
Average Daily Volume (sh)	**1,129,555**
Shares Outstanding (mil)	**808**
Market Capitalization ($mil)	**$103**
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	0.75 E	0.85 E	2.83 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 E	-$0.00 E	-$0.02 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

- Revenue increased by 85% and 86% year over year in fiscal 2Q14 and 1H14 respectively;
- Revenue will continue to grow with recent business development;
- Balance sheet remained strong;
- Business continues to grow;
- Maintain Outperform rating for APDN shares;

Highest Quarterly Revenue Reported for Fiscal 2Q

Total Revenues for the fiscal 2Q14 ended March 31, 2014 were $637,146, an 85% increase year over year. Sequentially, revenues grew 7% for the fiscal second quarter of 2014.

Although second quarter revenues were less than our estimate of $800,000, these are the highest revenues reported for the second quarter of any fiscal year in the history of the company.

Total Quarterly Net Revenue

Revenues			Variances			
			Q214 v Q213		Q214 vs. Q114	
Q114	Q214	Q213	$	%	$	%
$ 597,354	$ 637,146	$ 344,605	$ 292,541	85%	$ 39,792	7%

Total Year-to-Date Net Revenue

Revenues		Variances	
YTD	YTD	YTD	
2014	2013	$	%
$ 1,234,500	$ 662,275	$ 572,225	86%

During the quarter ended March 31, 2014, the Company entered into approximately $1 million of contracts and purchase orders, some of which are expected to be recognized in future quarters.

As of March 31, 2014, the Company also had $416K in deferred revenue, which will be recognized over the next 12 months.

Total operating expenses for fiscal 2Q14 increased to $3.7 million compared to $3.0 million for fiscal 2Q13, a 27% increase. This increase was primarily attributable to higher salary expense due to an increase in headcount from 38 as of March 31, 2013 to 52 as of March 31, 2014.

Net loss for the three months ended March 31, 2014 decreased to $2,750,436 ($0.00 per share) from a net loss of $3,127,631($0.00 per share) for the three months ended March 31, 2013.

For the first six months of this fiscal year, the Company generated approximately $1.2 million in revenue, an increase of 86% from the same period last fiscal year, the highest revenues reported for the first six months of any fiscal year in the Company's history.

Net loss for the six months ended March 31, 2014 decreased to $9,042,086 ($0.00 per share) from a net loss of $11,832,388 ($0.00 per share) for the six months ended March 31, 2013.

Revenue Will Continue to Grow Going Forward

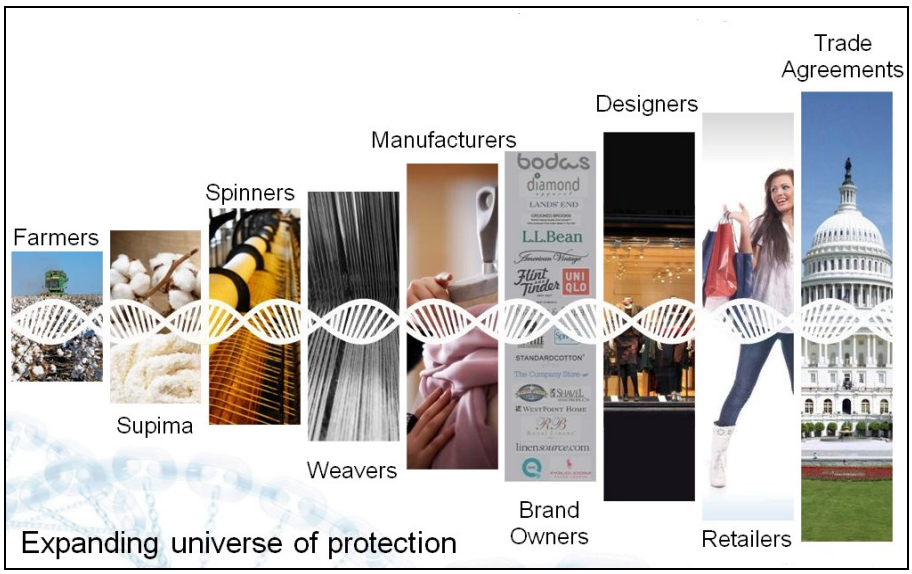
We think fiscal second quarter was another strong quarter for APDN in terms of financial performance. APDN reported highest second quarter sales in the Company's history.

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 $3.3 million for 2Q14 from $3.8 million for the 1Q14, a decrease of 13%. 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.



Balance Sheet Remained Relatively Strong

On Jul 22, 2013, APDN announced that it has entered into a Securities Purchase Agreement with an institutional accredited investor, Crede CG III, Ltd. to provide $7.5 million in financing.

Crede is an existing shareholder of the Company. At the initial closing, the Company received gross proceeds of $2,000,000 in exchange for restricted common stock priced at $0.187/share.

Pursuant to the Agreement, the investor is obligated to invest an additional $5,500,000 in the Company on the date a registration statement providing for the resale of the securities issued is declared effective by the Securities and Exchange Commission. This closing will be done at $1,000 per share of preferred stock with a conversion price the lesser of market value or $0.187/share. 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. The preferred stock is subject to conversion into common stock at the Company's option following the effectiveness of the registration statement and automatically converts after one year.

Warrants issued as a part of this financing could contribute up to an additional $9.75 million in funds to the company if exercised for cash. The Warrants also have a cashless exercise feature. Warrants would be exercised at a strike price equal to $0.2431 per share which is a 30% premium to the original purchase price of $0.187/share.

This financing comes at an excellent time. It greatly boosted balance sheet of the Company. This financing will allow APDN to continue to scale its operations and broaden its product line to meet the demand of a growing number of contracts in electronics and other verticals, continue to hire top sales, operational, and scientific talent, leverage valuable assets acquired from RedWeb Technologies, and further expand the company's market share in Europe.

As of March31, 2014, Applied DNA had $2.0 in cash. 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.**

APDN is at a crucial stage in the development of Applied DNA Sciences. The strong balance sheet will enhance its capacity to respond to growth opportunities.

Business Continues to Grow

During the conference call, CEO James Hayward talked about the achievements APDN has made during the quarter.

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

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.

In March, 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. Today's global polyolefin market has a size of about 140 billion kilograms 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.

In March 2014, APDN had 100% customer retention in the military customer market vertical. More than one half-million parts have been marked, with 30 companies participating, 14 of them original equipment or component manufacturers, prime defense contractors or authorized distributors. Each military customer must renew its contract annually in order to receive a new unique DNA mark that is required for marking products only for that 12-month period.

In conjunction with Centralne Biuro Zabezpieczeń (CBZ) of Poland, the Company introduced its SigNature DNA forensic anti-theft product into Poland.

We are pleased to see that APDN's sales pipeline and its customer base continue to grow. With a strong infrastructure in place and an experienced team of employees and management, APDN is delivering against stronger demands.

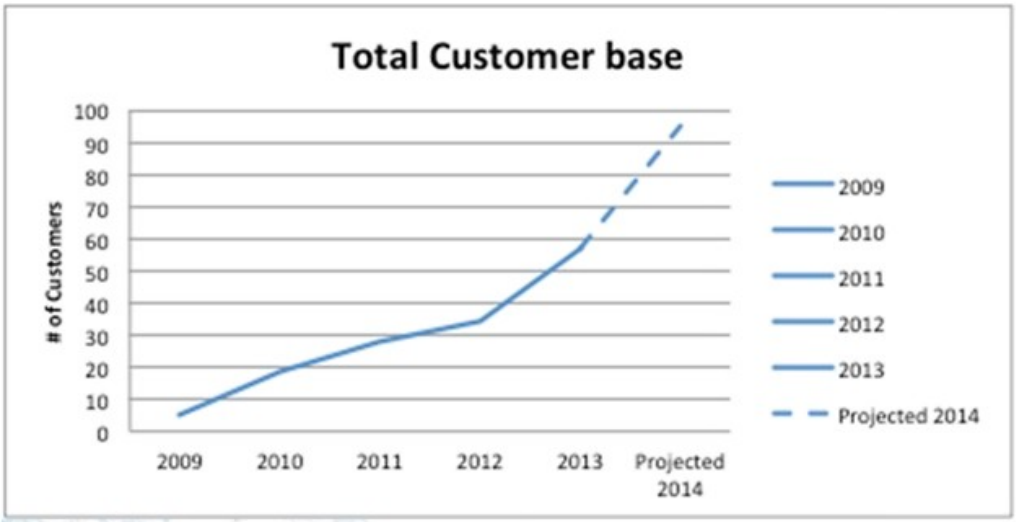
In the past few months, APDN has taken more steps concerning its SigNature DNA marking and authentication platform and bolstering its plant and staff. The Company continues to make great progress in business development. Personnel have been added, and plant capacity has been increased by over 50%. We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

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 encouraged by the strong financial performance for the fiscal second quarter and fiscal first half of the year of the Company. Revenue increased 85% for the fiscal 2Q14 and 86% for the fiscal 1H14, respectively, which represented the highest second quarter and first half 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 $202 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

	2012 (Sep)	2013 (Sep)					2014E (Sep)					2015E (Sep)	2016E (Sep)	2017E (Sep)	2018E (Sep)	2019E (Sep)	2020E (Sep)
$ in million except per share data	FYA	Q1	Q2	Q3	Q4	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE	FYE	FYE	FYE
Total Revenues	**$1.85**	**$0.32**	**$0.34**	**$0.64**	**$0.73**	**$2.04**	**$0.60**	**$0.64**	**$0.75**	**$0.85**	**$2.83**	**$4.50**	**$10.00**	**$15.00**	**$20.00**	**$27.50**	**$35.00**
YOY Growth	*91.5%*	*-38.5%*	*-33.5%*	*22.0%*	*150.7%*	*9.8%*	*88.0%*	*84.9%*	*16.3%*	*16.6%*	*39.2%*	*58.8%*	*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	0.00
Gross Income	**1.85**	**0.32**	**0.34**	**0.64**	**0.73**	**2.04**	**0.60**	**0.64**	**0.75**	**0.85**	**2.83**	**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%*	*100.0%*
SG&A	$7.6	$2.5	$2.8	$3.2	$2.7	$11.2	$3.8	$3.3	$3.0	$3.1	$13.2	$13.5	$14.0	$15.0	$16.0	$17.5	$18.5
% SG&A	*410.6%*	*793.6%*	*799.3%*	*502.6%*	*367.9%*	*550.0%*	*643.8%*	*517.6%*	*400.0%*	*364.7%*	*467.2%*	*300.0%*	*140.0%*	*100.0%*	*80.0%*	*63.6%*	*52.9%*
R&D	$0.43	$0.15	$0.18	$0.18	$0.18	$0.69	$0.46	$0.36	$0.30	$0.30	$1.42	$1.45	$1.50	$1.65	$1.70	$1.80	$1.95
% R&D	*23.3%*	*46.5%*	*51.2%*	*28.7%*	*25.1%*	*34.0%*	*76.9%*	*56.5%*	*40.0%*	*35.3%*	*50.1%*	*32.2%*	*15.0%*	*11.0%*	*8.5%*	*6.5%*	*5.6%*
Other	$0.3	$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	*16.9%*	*6.6%*	*6.3%*	*9.7%*	*29.6%*	*15.8%*	*17.6%*	*16.8%*	*13.3%*	*11.8%*	*14.5%*	*6.7%*	*3.0%*	*2.0%*	*1.5%*	*1.1%*	*0.9%*
Operating Income	**($6.5)**	**($2.4)**	**($2.6)**	**($2.8)**	**($2.4)**	**($10.2)**	**($3.8)**	**($3.1)**	**($2.7)**	**($2.7)**	**($12.2)**	**($10.8)**	**($5.8)**	**($2.0)**	**$2.0**	**$7.9**	**$14.3**
Operating Margin	*-350.9%*	*-746.7%*	*-756.8%*	*-440.9%*	*-322.6%*	*-499.7%*	*-638.3%*	*-490.8%*	*-353.3%*	*-311.8%*	*-431.8%*	*-238.9%*	*-58.0%*	*-13.0%*	*10.0%*	*28.7%*	*40.7%*
Other Net	($0.6)	($6.3)	($0.5)	$0.7	($1.4)	($7.5)	($2.5)	$0.4	($0.3)	($0.3)	($2.6)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pre-Tax Income	**($7.2)**	**($8.7)**	**($3.1)**	**($2.1)**	**($3.7)**	**($17.7)**	**($6.3)**	**($2.8)**	**($2.9)**	**($2.9)**	**($14.8)**	**($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	$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%*	*0.0%*
Reported Net Income	**($7.2)**	**($8.7)**	**($3.1)**	**($2.1)**	**($3.7)**	**($17.7)**	**($6.3)**	**($2.8)**	**($2.9)**	**($2.9)**	**($14.8)**	**($10.8)**	**($5.8)**	**($2.0)**	**$2.0**	**$7.9**	**$14.3**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	-	-	*-66.38%*	*-202.56%*	*295.00%*	*80.38%*
Net Margin	*-385.5%*	*2740.2%*	*-907.6%*	*-331.2%*	*-510.0%*	*-868.6%*	-	-	-	-	-	-	-	*-13.0%*	*10.0%*	*28.7%*	*40.7%*
Shares Out	*576.1*	*649.9*	*680.4*	*721.1*	*763.9*	*703.9*	*789.9*	*808.2*	*808.6*	*825.0*	*807.9*	*865.0*	*915.0*	*965.0*	*1015.0*	*1050.0*	*1070.0*
Reported EPS	**($0.01)**	**($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	*$0.00*	*$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	**($7.2)**	**($2.4)**	**($3.1)**	**($2.1)**	**($3.7)**	**($11.4)**	**($3.7)**	**($2.8)**	**($2.9)**	**($2.9)**	**($12.2)**	**($10.8)**	**($5.8)**	**($2.0)**	**$2.0**	**$7.9**	**$14.3**
Non GAAP EPS	**($0.01)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.02)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.02)**	**($0.01)**	**($0.01)**	**($0.00)**	**$0.00**	**$0.01**	**$0.01**

Source: Company filing and Zacks Investment Research estimates

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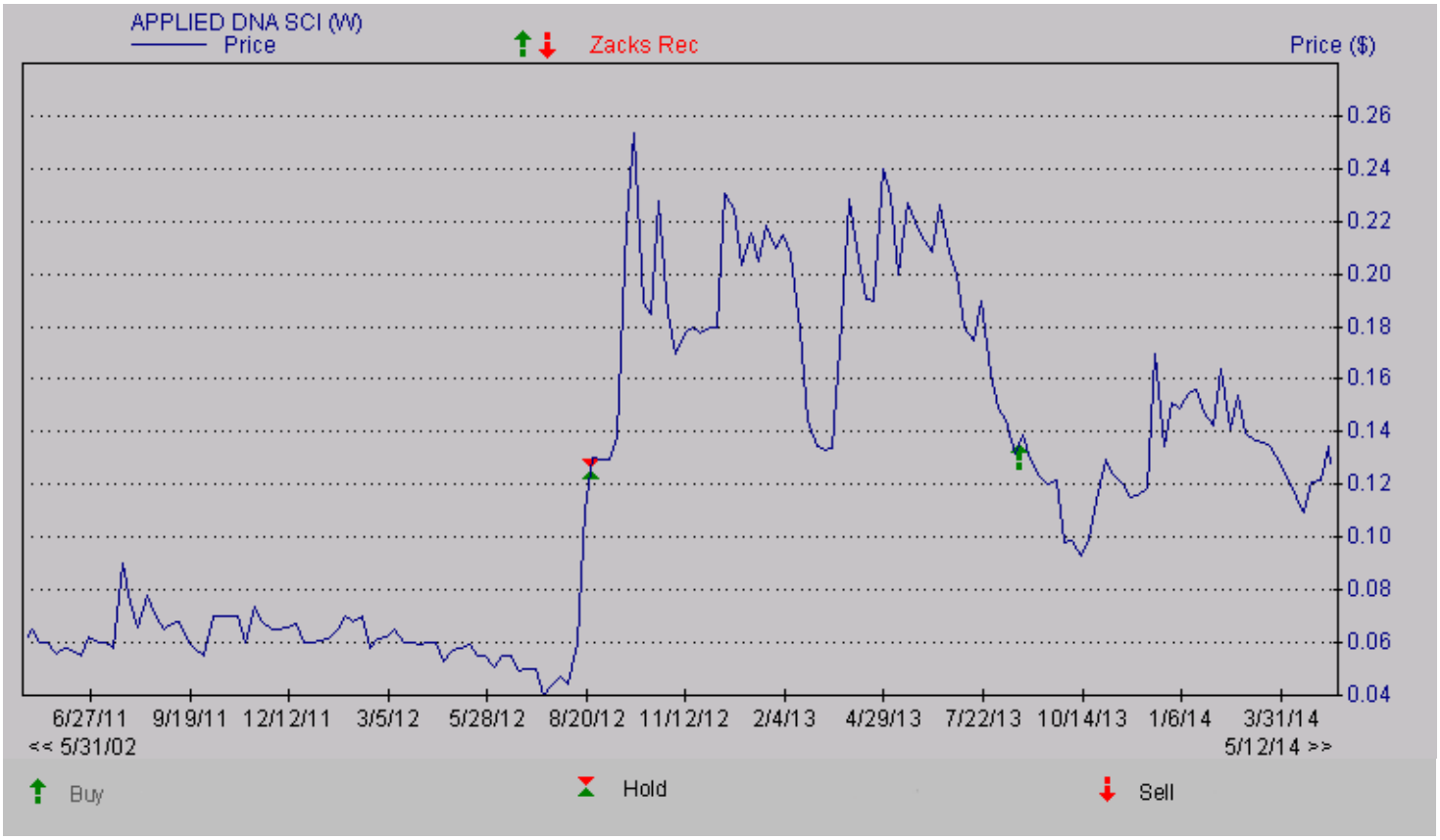
HISTORICAL ZACKS RECOMMENDATIONS



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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.

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