Zacks Small-Cap Research

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# Applied DNA Sciences (APDN-OTC)

**APDN:** Another strong quarter of financial performance---Outperform

| | |
|---|---|
| **Current Recommendation** | **Outperform** |
| Prior Recommendation | N/A |
| Date of Last Change | 08/12/2010 |
| Current Price (05/14/12) | $0.06 |
| **Twelve- Month Target Price** | **$0.15** |

## OUTLOOK

Applied DNA is a provider of plant-DNA based security and authentication solutions that can help protect products, brands and intellectual property of companies, governments and consumers from theft, counterfeiting, fraud and diversion. 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.

## SUMMARY DATA

| | |
|---|---|
| **52-Week High** | **$0.09** |
| **52-Week Low** | **$0.05** |
| **One-Year Return (%)** | **5.45** |
| **Beta** | **0.82** |
| **Average Daily Volume (sh)** | **231,149** |
| **Shares Outstanding (mil)** | **591** |
| **Market Capitalization ($mil)** | **$36** |
| **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 | 0.50 E | 0.50 E | 2.04 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 E | -$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

### *Another Strong Quarter of Financial Performance for APDN*

On May 15, Applied DNA Science Inc. (APDN) reported another strong quarter of financial results for the second quarter of 2012 ended January 31, 2012.

Total revenue in the quarter ending March 31, 2012 totaled $0.52 million, an increase of 269% compared to $0.14 million in the same quarter of 2011. Revenue also increased 0.3% quarter over quarter from $0.52 million for the quarter ending December 31, 2011. Fiscal second quarter revenue also exceeded our estimate of $0.40 million. The increase in revenues was substantially generated from sales of SigNature® DNA and BioMaterial GenoTyping™, the Company's principal anti-counterfeiting and product authentication solutions.

The six-month period of FY12 to-date has already exceeded (by 7%) total revenues of FY11.Revenues for the six-month period have increased by 126% year over year, topping $1 million for the first time.

SG&A expenses increased from $1.6 million for the three months ended March 31, 2011 to $1.8 million for the three months ended March 31, 2012. The increase of $205,291 represents a 12.7% increase over the same quarter in the prior fiscal year.

The Company incurred research and development expenses of $96,097 and $92,951 for the three-month periods ended March 31, 2012 and 2011, respectively. The increase is attributable to additional research and development activity needed with current operations.

Total operating expenses decreased to $2.0 million for the three months ended March 31, 2012 from $2.3 million for the three months ended December 31, 2011, a decrease of $309,823 quarter over quarter, representing a 13% reduction. Compared year over year for the quarter ending March 31, total operating expenses increased by $215,252 or 12%.

Net loss in the three months ended March 31, 2012 decreased to $1.6 million from a net loss of $2.6 million for the three months ended March 31, 2011, a decrease of 40%. Net loss dropped 36% for the quarter as compared to the quarter ending December 31, 2011.

The Company began fiscal year 2012 with a strong first quarter and second quarter has 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.

According to management, the Company's developments in the cash-in-transit, semiconductor authentication and textile and apparel authentication markets have sustained strong momentum and contributed to the increase in total revenues. Management intends to pursue both domestic and international sales opportunities in each of these vertical markets.

The Company continues to add new customers or expand existing partnerships on the business development front. In addition, the initial responses to the Company's new product lines, smartDNA® and digitalDNA™, have been encouraging.

We are also pleased to see revenues increase while expenses are controlled closely.

### *Business Continues to Grow*

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

On **May 10, 2012**, APDN launched a new, DNA-secured form of the QR (quick read) code. **digitalDNA**™ is a new security tool that utilizes the flexibility of mobile communications, the instant accessibility of secure, cloud-based data, and the absolute certainty of DNA to make item tracking and authentication fast, easy and definitive, while providing the opportunity to create a new and exciting customer interface.

The product uses forensic authentication of a botanical DNA marker, sequence-encrypted within a secure QR code, and physically included within the ink used to digitally print the code. The resulting pattern or "rune" can be scanned via an Apple-approved app with an iPhone to assure originality. These mobile scans can be performed anywhere along the supply chain without limit.

The technology avoids the risks of phishing scams to which non-secure QR codes are notoriously vulnerable, while providing authentication, geolocation and time-stamping throughout the supply chain. The ubiquity of the iPhone platform allows the consumer to participate in the authentication scheme, quickly and easily. In addition, end-users could confirm freshness and expiration, connect to real-time or video technical support, identify local resources, easily place reorders, and participate in peer-to-peer selling.

The digitalDNA platform is designed to meet compliance specifications defined by the PCI (Payment Card Industry) Security Standards Council, the new and strict standards developed for handling credit card transactions, and HIPAA (Health Insurance Portability and Accountability Act), the stringent requirements for protecting personal health information.

The technology evolved from a partnership agreement signed with secure cloud-computing specialist DivineRune, Inc, on January 25th of this year. The partnership will enhance and extend APDN's core anti-counterfeiting, anti-diversion, and security systems into the digital track-and-trace sphere. The companies jointly described the agreement as "taking APDN's best-in-class anti-counterfeiting and authentication systems and marrying them to the best in secure mobile applications and advanced cloud computing."

On **March 30, 2012**, APDN announced that its botanical, **smartDNA**™ anti-theft system, successfully deployed by Stockholm county police in 2011, is now officially approved by the Swedish National Police Board to be used by law enforcement in all counties in Sweden beginning June 2012.

From June 2012, the entire Swedish police force will be working with smartDNA, as a covert method of linking criminals to crimes. The successful adoption of this system by the Swedish police has helped them to positively link criminals to serious crimes, and this has resulted in a number of arrests.

Since the launch of smartDNA, in Sweden, over 40 locations have installed smartDNA spray systems. In the United States, smartDNA products and spray systems are available, and are installed in a number of bank and pharmacy locations on Long Island, New York. The number of stores within the initial jewelry chain is expected to sharply rise. Additional jewelry chains and associations have inquired about smartDNA, as well as banks, pharmacies and ATM owners.

On **March 28, 2012**, APDN and Holliston LLC announced they are working together to develop **the next generation security platform** for various product coatings, including passports and luxury packaging materials, with botanical SigNature DNA®.

As the nation's oldest and largest manufacturer of cloth coverings, Holliston has served the book cover material, packaging fabric, and industrial cloth markets since 1895. Holliston remains the U.S. Government's preferred supplier of high-security passport cover material.

Applied DNA Sciences and Holliston are developing and testing DNA-coatings that essentially cannot be copied, and provide a means for customs and law enforcement groups to authenticate products in the field, and in the lab. The joint work has resulted in a feasibility study that successfully demonstrated the

ability to incorporate botanical SigNature DNA onto passport covers. The next phase of the collaboration is to develop working prototypes, and move toward scaling up the process for commercial production.

## VALUATION AND RECOMMENDATION

We reiterate our Outperform rating on Applied DNA, and our twelve-month price target is $0.15 based on the Company's strong financial performance and operational achievements in recent quarters as well as recent positive business developments. Since we initiated our coverage of Applied DNA Sciences Inc. in early September 2010, the Company has made great progress in terms of financial performance as well as in business development. We believe top line growth will be further boosted in the coming quarters.

The Company's fundamentals remain strong. The Company's technology is unique and has competitive advantages over its peers. We are optimistic about the Company's prospect. The Company is well positioned to boost both 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 129% 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.

Currently, the Company trades around $0.06 per share with a market cap of $36 million. We believe this undervalues the Company based on the company's fundamentals. We understand that market discounts the value of the Company because the Company has only limited revenue base and has been losing money since its inception. We also understand that the Company has a weak balance sheet and further financing is needed very soon. However, when we look at the Company and the industry in which the Company operates in more detail, we realize that this is a Company with huge opportunity and can grow its revenue and earnings at a tremendous rate in the next few years.

We think the Company should trade around a P/E of 20x, which is only half of 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 $0.15 per share. This values the company at $88 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. Since its inception, Applied DNA has been losing money and has had negative operating cash flow.

As of March 31, 2012, the Company had only $0.86 million in cash and cash equivalents. At the same time, there is a balance of $0.25 million convertible notes sitting on its balance sheet payable within one year. Current cash can last one quarter. We believe APDN needs to tap the capital market very soon.

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 591 million at the end of march 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.

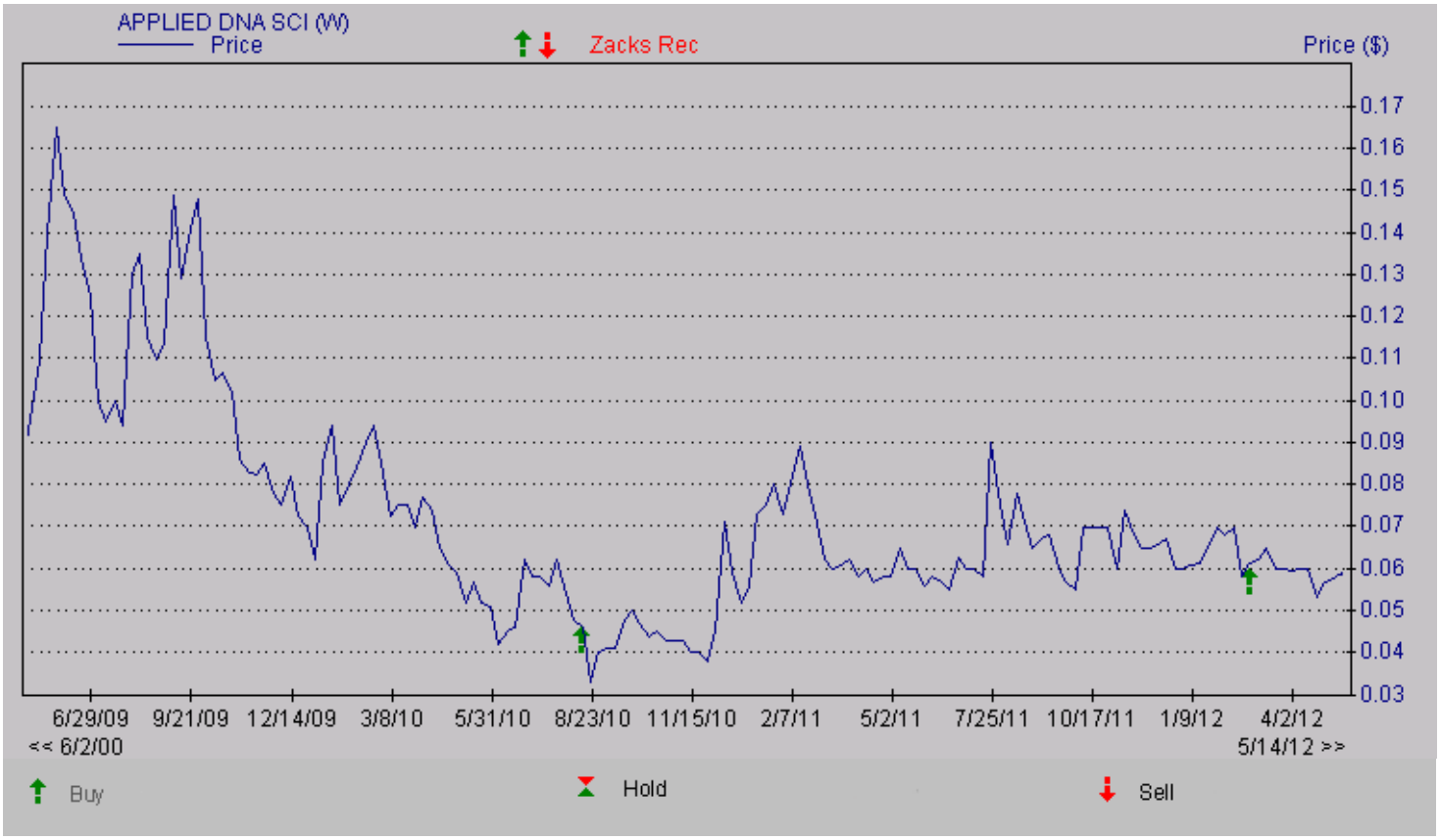
## PROJECTED INCOME STATEMENT

| | 2010A (Sep) | 2011A (Sep) | | | | | 2012E (Sep) | | | | | 2013E (SEP) | 2014E (Sep) | 2015E (Sep) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $ in million except per share data | FYA | Q1 | Q2 | Q3 | Q4 | FYA | Q1 | Q2 | Q3 | Q4 | FYE | FYE | FYE | FYE |
| **Total Revenues** | **$0.52** | **$0.32** | **$0.14** | **$0.23** | **$0.28** | **$0.97** | **$0.52** | **$0.52** | **$0.50** | **$0.50** | **$2.04** | **$5.50** | **$10.00** | **$24.50** |
| *YOY Growth* | *76.1%* | *337.1%* | *-25.0%* | *35.0%* | *213.1%* | *86.3%* | *62.6%* | *269.1%* | *117.7%* | *78.1%* | *110.1%* | *170.2%* | *81.8%* | *145.0%* |
| *CoGS* | 0.06 | 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** | **0.46** | **0.30** | **0.13** | **0.23** | **0.28** | **0.97** | **0.52** | **0.52** | **0.50** | **0.50** | **2.04** | **4.97** | **9.04** | **22.14** |
| *Gross Margin* | *87.9%* | *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 | $7.1 | $1.3 | $1.6 | $1.6 | $3.9 | $8.4 | $2.2 | $1.8 | $1.9 | $2.0 | $7.9 | $8.5 | $9.0 | $11.0 |
| *% SG&A* | *1370.8%* | *411.9%* | *1143.0%* | *688.2%* | *1387.3%* | *866.0%* | *416.4%* | *352.0%* | *380.0%* | *400.0%* | *387.0%* | *154.5%* | *90.0%* | *44.9%* |
| R&D | $0.08 | $0.02 | $0.09 | $0.05 | $0.11 | $0.27 | $0.08 | $0.10 | $0.09 | $0.10 | $0.36 | $0.35 | $0.37 | $0.40 |
| *% R&D* | *14.6%* | *6.5%* | *66.2%* | *20.9%* | *38.2%* | *27.8%* | *15.2%* | *18.5%* | *18.0%* | *20.0%* | *17.9%* | *6.4%* | *3.7%* | *1.6%* |
| Other | $0.4 | $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* | *71.5%* | *29.2%* | *65.4%* | *40.0%* | *32.4%* | *37.9%* | *19.0%* | *19.0%* | *20.0%* | *20.0%* | *19.5%* | *7.3%* | *4.0%* | *1.2%* |
| **Operating Income** | **($7.1)** | **($1.1)** | **($1.7)** | **($1.5)** | **($3.8)** | **($8.1)** | **($1.8)** | **($1.5)** | **($1.6)** | **($1.7)** | **($6.6)** | **($4.3)** | **($0.7)** | **$10.4** |
| *Operating Margin* | *-1369.1%* | *-354.0%* | *-1184.6%* | *-649.1%* | *-1357.9%* | *-835.3%* | *-350.6%* | *-289.6%* | *-318.0%* | *-340.0%* | *-324.4%* | *-77.8%* | *-7.3%* | *42.6%* |
| Other Net | ($0.8) | ($0.2) | ($0.9) | ($0.7) | ($0.6) | ($2.5) | ($0.6) | ($0.1) | ($0.1) | ($0.1) | ($0.8) | ($1.0) | ($1.0) | ($1.0) |
| **Pre-Tax Income** | **($7.9)** | **($1.3)** | **($2.6)** | **($2.2)** | **($4.5)** | **($10.5)** | **($2.4)** | **($1.6)** | **($1.7)** | **($1.8)** | **($7.4)** | **($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 | $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** | **($7.9)** | **($1.3)** | **($2.6)** | **($2.2)** | **($4.5)** | **($10.5)** | **($2.4)** | **($1.6)** | **($1.7)** | **($1.8)** | **($7.4)** | **($5.3)** | **($1.7)** | **$9.4** |
| *YOY Growth* | - | - | - | - | - | - | - | - | - | - | - | *-28.5%* | *-67.2%* | *-644.5%* |
| *Net Margin* | *-1521.6%* | *-422.9%* | *-1850.3%* | *-938.1%* | *-1586.1%* | *1089.1%* | *-466.2%* | *-301.1%* | *-330.0%* | *-352.0%* | *-362.6%* | *-96.0%* | *-17.3%* | *38.5%* |
| *Shares Out* | *300.4* | *349.2* | *351.4* | *352.0* | *455.0* | *376.9* | *490.3* | *583.6* | *591.0* | *593.0* | *564.5* | *650.0* | *700.0* | *750.0* |
| **Reported EPS** | **($0.03)** | **($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* | - | - | - | - | - | - | - | - | - | - | - | *-37.9%* | *-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* | *$0.00* |
| **Non GAAP Net Income** | **($7.9)** | **($1.3)** | **($2.6)** | **($2.2)** | **($4.5)** | **($10.5)** | **($2.4)** | **($1.6)** | **($1.7)** | **($1.8)** | **($7.4)** | **($5.3)** | **($1.7)** | **$9.4** |
| **Non GAAP EPS** | **($0.03)** | **($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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