Zacks Small-Cap Research

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Applied DNA Sciences (APDN-OTC)

APDN: Record revenue reported for fiscal 2Q15, balance sheet boosted, businesses continue to grow--Buy

Current Recommendation	**Buy**
Prior Recommendation	Neutral
Date of Last Change	08/21/2013
Current Price (05/11/15)	$2.46
Twelve- Month Target Price	**$10.00**

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 2Q15 ended March 31, 2015. We expect to see further growth of revenue in the rest of fiscal 2015 and beyond.

SUMMARY DATA

52-Week High	**$8.20**
52-Week Low	**$2.08**
One-Year Return (%)	**-67.88**
Beta	**2.00**
Average Daily Volume (sh)	**81,079**
Shares Outstanding (mil)	**21**
Market Capitalization ($mil)	**$53**
Short Interest Ratio (days)	**0.74**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
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)
2014	0.60 A	0.64 A	0.84 A	0.65 A	2.72 A
2015	1.24 A	1.52 A	1.60 E	1.70 E	6.06 E
2016					12.00 E
2017					17.50 E

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

	Q1 (Dec)	Q2 (Mar)	Q3 (Jun)	Q4 (Sep)	Year (Sep)
2014	-$0.28 A	-$0.20 A	-$0.14 A	-$0.15 A	-$0.77 A
2015	-$0.25 A	-$0.11 A	-$0.13 E	-$0.13 E	-$0.60 E
2016					-$0.22 E
2017					$0.00 E

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

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WHAT'S NEW

- Revenue surpassed the $1.5 million mark first time in the company's history;
- New financing boosts balance sheet;
- Business continues to grow;
- We maintain our Buy rating and reiterate our 12-month price target of $10 per share;

APDN Reports 138% Revenue Growth for Fiscal 2Q15

On May 12, Applied DNA Sciences (APDN) reported its second fiscal quarter of 2015 financial results ended March 31, 2015.

Revenues for the 2Q15 increased 138% to a record $1.5 million, compared with $637,000 reported in the second quarter of fiscal 2014, and a 22% increase from $1.2 million reported in the first fiscal quarter ended December 31, 2014. This increase was primarily due to an increase in revenues from government contracts.

Revenue for fiscal 2Q15 also exceeded our estimate of $1.28 million.

Total operating expenses for 2Q15 were $3.4 million, compared with $3.8 million in the prior year's quarter, a decrease of approximately $367,000 (10%). The decrease was primarily attributable to a decrease in legal fees, as well as lower SG&A as a result of management's cost-savings program.

Net loss for fiscal 2Q15 was $1.9 million ($0.11 per share), compared with a net loss of $2.8 million ($0.20 per share) for the three months ended March 31, 2014 and a net loss of $7.8 million ($0.51 per share) for the three months ended December 31, 2014.

	Quarter Ended March 31,		Variance		Year to Date Ended March 31,		Variance	
	2015	2014	$	%	2015	2014	$	%
Revenues	$ 1,518,761	$ 637,146	881,615	138%	$ 2,760,563	$ 1,234,500	1,526,063	124%
Operating expenses:								
Selling, general and administrative	2,901,207	3,297,739	(396,532)	-12%	7,569,950	7,143,317	426,633	6%
Research and development	373,380	359,782	13,598	4%	651,652	819,086	(167,434)	-20%
Depreciation and amortization	123,079	106,810	16,269	15%	232,805	212,025	20,780	10%
Total operating expenses	3,397,666	3,764,331	(366,665)	-10%	8,454,407	8,174,428	279,979	3%
LOSS FROM OPERATIONS	(1,878,905)	(3,127,185)	(1,248,280)	-40%	(5,693,844)	(6,939,928)	(1,246,084)	-18%
Other income (expense)	(6,677)	376,749	383,426	-102%	(4,020,376)	(2,102,158)	1,918,218	91%
NET LOSS	**$ (1,885,582)**	**$ (2,750,436)**	**(864,854)**	**-31%**	**$ (9,714,220)**	**$ (9,042,086)**	**672,134**	**7%**

Excluding non-cash expenses, adjusted EBITDA for the fiscal 2Q15 would have been a negative $1.2 million compared to a negative adjusted EBITDA of $2.6 million for the fiscal 2Q14 and a negative adjusted EBITDA of $1.7 million for the prior fiscal quarter. The improvement in adjusted EBITDA is primarily related to the increased revenues and decreased operating expenses for the three months ended March 31, 2015.

	Three Month Period Ended March 31,			Six Month Period Ended March 31,		
	2015	2014	% Variance	2015	2014	% Variance
Net Loss	$(1,885,582)	$(2,750,436)		$(9,714,220)	$(9,042,086)	
Interest expense (income), net	(16)	(239)		31,859	(673)	
Depreciation and amortization	123,079	106,810		232,805	212,025	
Loss on change in fair value of warrant liability	-	(455,899)		2,994,540	2,178,859	
Stock based compensation expense	539,996	547,784		2,538,519	1,650,831	
(Gain) loss on conversion of promissory notes	-	-		980,842	-	
Bad debt expense	-	1,144		2,779	16,144	
Total non-cash items	663,059	199,600		6,781,344	4,057,186	
Consolidated Adjusted EBITDA (loss)	**$(1,222,523)**	**$(2,550,836)**	-52%	**$(2,932,876)**	**$(4,984,900)**	-41%

We are very impressed by the 138% revenue growth for the fiscal 2Q15, which surpassed the $1.5 million mark for the first time in the company's history. With the recent financing and increased business activities, we believe revenue will continue to grow in the rest of fiscal 2015 and beyond.

New Financing Boosts Balance Sheet

In April, 2015, APDN closed a underwritten public offering of 4,011,000 shares of common stock and warrants to purchase up to an aggregate of 1,604,400 shares of common stock, at a combined offering price of $3.00, including 191,000 shares and 76,400 warrants sold pursuant to the partial exercise of the underwriters' over-allotment option. The warrants have a per share exercise price of $3.50, are exercisable immediately, and expire on November 20, 2019.

The gross proceeds to the Company from this offering are $12.0 million.

The underwriters still have a 45 day option to purchase up to an additional 382,000 shares of common stock and 152,800 warrants, to cover additional over-allotments, if any.

This offering is a great boost to the company's balance sheet. As of March 31, 2015, APDN held $1.0 million in cash. With the new financing, current cash should be able to fund the company's operations into 2H16.

New Business Development

On April 10, 2015, APDN announced plans to utilize APDN's DNAnet kits for home asset marking and protection.

DNAnet comes as a turnkey kit, ready to use and complete with home and vehicle alert signs. Communities can use signage to assert that DNAnet is being employed in their community to prevent crimes. Each kit has a unique DNA mark with the capacity to mark up to 100 items. Application is easy, involving a quick swab of DNAnet onto an item, followed by registration of the item on a secure site.

On March 25, 2015, APDN entered into a mutual license agreement with **Divatex**, a leading supplier of home textiles, to commercialize the world's first supply-chain-DNA-verified cotton product. Divatex is responsible for marketing, while APDN licenses its patented SigNature T DNA technology for application to ensure the veracity of the product.

On March 18, 2015, APDN announced a landmark in the deployment of its SigNature® DNA technology as a physical or chemical drug formulation identifier (PCID) in the **pharmaceutical industry**. APDN has incorporated its SigNature DNA into ordinary pharmaceutical grade inks; successfully marked more than

10,000 prescription drugs, acetaminophen gel-tabs and aspirin tablets with the DNAembedded ink; and shown that the DNA in those inks can be detected as a PCID and used for authentication via proprietary DNA amplification technologies.

Of greatest significance is that APDN has shown that the SigNature DNA printed upon standard pharmaceutical dosages is now forensically detectable in a field-deployable format. Using company developed PCR (Polymerase Chain Reaction) and isothermal amplification methods, kits and devices, based on SigNature DNA, customers will be able to conduct on-the-spot field authentication of electronic devices, fibers such as wool and cotton, other high value commodities and now, for the first time, pharmaceutics.

The technology satisfies the principles established by FDA Guidelines for inclusion in pharmaceutics and is equally applicable to food and cosmetic products. APDN is currently involved in a trial with one of the world's largest pharmaceutic companies. The trial is being conducted through one of APDN's channel partners.

APDN can DNA-mark bulk Active Pharmaceutical Ingredient (API), often manufactured off-shore, enabling verification of its authenticity at any point in the supply chain. The company has also DNAmarked the cellulosic excipients (bulk fillers) that are used in almost all drug tablets and the commercial binders and enteric coatings that hold prescription and Over-the-Counter (OTC) drug tablets together.

It is extremely difficult to precisely estimate the prevalence of economic impact of counterfeit drugs since most counterfeit transactions take place sub rosa. The World Health Organization (WHO) has estimated that globally, up to 10% of prescription drugs are counterfeit, while multiple sources estimate that global sales of counterfeit drugs exceed $200 billion annually.

On March 3, 2015, APDN entered into an agreement with **United Pharmacy Network** to recommend the award winning SmokeCloak® DNA system to its 160 members in the NY metro area and several other states, primarily Texas. When deployed in pharmacies, banks, commercial/retail locations, SmokeCloak DNA helps protect staff, customers and assets. A thick and disorienting fog wards off offenders and deposits a unique, location-specific DNA marker on skin, clothing and stolen items.

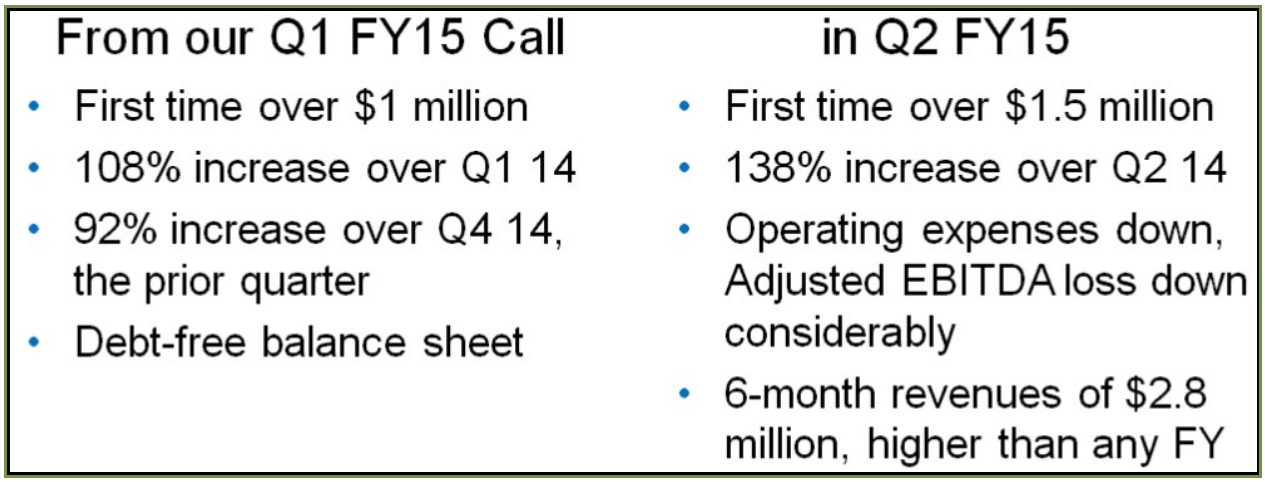
On February 26, 2015, APDN announced the expansion of its digitalDNA® software and services platform to enable customers' business process controls and supply chain partner collaboration throughout the entire lifecycle of marking, validating and authenticating goods. The new features enhance the foundation of bar code item tracking layered with SigNature® DNA as the forensic backstop.

On February 17, 2015, APDN launched a new technology, based on the use of a panel of novel, fluorescent, encrypted security elements, the patent-pending "**DNA Beacon**" technology, that is designed to integrate seamlessly with our SigNature® DNA platform. The Beacon technology is designed to identify APDN DNA-marked products, by encrypted fluorescence, throughout an entire supply chain or through high-value asset chain-of-custody. By combining the company's flagship SigNature DNA mark with the new Beacon technology, APDN's new combined technology platform can now accelerate the fight against counterfeiting, diversion and theft. Once a product is marked, identification in the field is easily conducted with the use of a simple Beacon activator (which chemically decrypts the Beacon) and a UV light, to be followed by forensic-grade DNA authentication, when required.

We Maintain Our Buy rating with a 12-Month Price Target of $10.00

Based on the recent achievements, we maintain our Buy rating for APDN shares and reiterate our 12-month price target of $10.00 per share.

We are impressed by the stellar financial performance for the fiscal 2Q15 and for the first six months of fiscal 2015. Revenue increased 138% year over year, and 22% quarter over quarter. The company achieved the highest quarterly revenue ever in the Company's history, which exceeded the $1.5 million mark. Below is the summary of the achievements for fiscal first quarter and fiscal first half of 2015.



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 quarters. According to our long term financial model, the Company's revenue will grow at a compound annual growth rate (CAGR) of 68% in the next 6 fiscal years from 2014 to 2020. APDN will break even in 2017 and become profitable in fiscal 2018 with net income of $7.0 million or EPS of $0.27 per share.

APDN is a high growth company. In terms of valuation, we apply a P/E of 32x to our estimated EPS of $0.81 in fiscal 2020, discounted at 20% for 5 years. This way, we get our price target of $10.00 per share. This values the company at about $210 million in market cap based on 21 million outstanding shares, 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.

PROJECTED INCOME STATEMENT

	2013A (SEP)	2014A (Sep)	2015E (Sep)					2016E (Sep)	2017E (Sep)	2018E (Sep)	2019E (Sep)	2020E (Sep)
$ in million except per share data	FYA	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE	FYE	FYE
Total Revenues	**$2.04**	**$2.72**	**$1.24**	**$1.52**	**$1.60**	**$1.70**	**$6.06**	**$12.00**	**$17.50**	**$25.00**	**$35.00**	**$45.00**
YOY Growth	*9.8%*	*33.6%*	*107.9%*	*138.4%*	*90.2%*	*163.4%*	*122.7%*	*98.0%*	*45.8%*	*42.9%*	*40.0%*	*28.6%*
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
Gross Income	**2.04**	**2.72**	**1.24**	**1.52**	**1.60**	**1.70**	**6.06**	**12.00**	**17.50**	**25.00**	**35.00**	**45.00**
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%*
SG&A	$11.2	$13.2	$4.7	$2.9	$3.5	$4.0	$15.1	$15.0	$15.5	$16.0	$17.5	$18.5
% SG&A	*550.0%*	*486.9%*	*376.2%*	*191.0%*	*218.8%*	*235.3%*	*248.7%*	*125.0%*	*88.6%*	*64.0%*	*50.0%*	*41.1%*
R&D	$0.69	$1.30	$0.28	$0.37	$0.38	$0.42	$1.45	$1.50	$1.65	$1.70	$1.80	$1.95
% R&D	*34.0%*	*47.8%*	*22.4%*	*24.6%*	*23.8%*	*24.7%*	*24.0%*	*12.5%*	*9.4%*	*6.8%*	*5.1%*	*4.3%*
Other	$0.3	$0.4	$0.1	$0.1	$0.1	$0.1	$0.4	$0.3	$0.3	$0.3	$0.3	$0.3
% Other	*15.8%*	*16.3%*	*8.8%*	*8.1%*	*6.3%*	*5.9%*	*7.1%*	*2.5%*	*1.7%*	*1.2%*	*0.9%*	*0.7%*
Operating Income	**($10.2)**	**($12.3)**	**($3.8)**	**($1.9)**	**($2.4)**	**($2.8)**	**($10.9)**	**($4.8)**	**$0.1**	**$7.0**	**$15.4**	**$24.3**
Operating Margin	*-499.7%*	*-451.0%*	*-307.4%*	*-123.7%*	*-148.8%*	*-165.9%*	*-179.8%*	*-40.0%*	*0.3%*	*28.0%*	*44.0%*	*53.9%*
Other Net	($7.5)	($0.8)	($4.0)	($0.0)	$0.0	$0.0	($4.0)	$0.0	$0.0	$0.0	$0.0	$0.0
Pre-Tax Income	**($17.7)**	**($13.1)**	**($7.8)**	**($1.9)**	**($2.4)**	**($2.8)**	**($14.9)**	**($4.8)**	**$0.1**	**$7.0**	**$15.4**	**$24.3**
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
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%*
Reported Net Income	**($17.7)**	**($13.1)**	**($7.8)**	**($1.9)**	**($2.4)**	**($2.8)**	**($14.9)**	**($4.8)**	**$0.1**	**$7.0**	**$15.4**	**$24.3**
YOY Growth	-	-	-	-	-	-	-	-	-	-	*120.00%*	*57.47%*
Net Margin	-	-	-	-	-	-	-	-	-	*28.0%*	*44.0%*	*53.9%*
Shares Out	*20.1*	*13.5*	*15.5*	*17.4*	*19.0*	*21.0*	*18.2*	*22.0*	*24.0*	*26.0*	*28.0*	*30.0*
Reported EPS	**($0.88)**	**($0.97)**	**($0.51)**	**($0.11)**	**($0.13)**	**($0.13)**	**($0.82)**	**($0.22)**	**$0.00**	**$0.27**	**$0.55**	**$0.81**
YOY Growth	-	-	-	-	-	-	-	-	*-101.0%*	*12823.1%*	*104.3%*	*47.0%*
One time charge	*$6.33*	*$2.63*	*$4.01*	*$0.00*	*$0.00*	*$0.00*	*$4.01*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*
Non GAAP Net Income	**($11.4)**	**($10.4)**	**($3.8)**	**($1.9)**	**($2.4)**	**($2.8)**	**($10.9)**	**($4.8)**	**$0.1**	**$7.0**	**$15.4**	**$24.3**
Non GAAP EPS	**($0.56)**	**($0.77)**	**($0.25)**	**($0.11)**	**($0.13)**	**($0.13)**	**($0.60)**	**($0.22)**	**$0.00**	**$0.27**	**$0.55**	**$0.81**

Source: Company filing and Zacks Investment Research estimates

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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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