Zacks Small-Cap Research

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Applied DNA Sciences (APDN-OTC)

APDN: Expecting strong financials for fiscal 4Q12, raising price target to $0.25---Neutral

Current Recommendation	**Neutral**
Prior Recommendation	Outperform
Date of Last Change	08/23/2012
Current Price (11/26/12)	$0.18
Twelve- Month Target Price	**$0.25**

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.

We are expecting another strong quarter. We raise our price target to $0.25 per share accordingly.

OUTLOOK

SUMMARY DATA

52-Week High	**$0.27**
52-Week Low	**$0.04**
One-Year Return (%)	**175.38**
Beta	**1.21**
Average Daily Volume (sh)	**864,085**
Shares Outstanding (mil)	**627**
Market Capitalization ($mil)	**$115**
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	0.54 E	2.10 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 A	-$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 Expected

We expect APDN to report another strong quarter for the three month ending September 30, 2012.

The Company will report its fiscal fourth quarter of 2012 financials and business updates in the middle of December. We believe fiscal fourth quarter will be another strong quarter for the Company. We estimate total revenue will be around $0.54 million for the fiscal fourth quarter. Total revenue for fiscal 2012 ending September 30, 2012 will pass $2 million mark for the first time in the Company's history.

Fourth quarter EPS will be ($0.00) according to our model.

Cash balance will be low at the end of fiscal fourth quarter ending September 30, 2012. We expect APDN to tap the capital market very soon.

We maintain our Neutral rating for APDN, but raise our price target to $0.25 per share from previous $0.18 per share based on the expected strong fourth quarter financials.

Record Financial Results for Fiscal Third Quarter of 2012

On August 14, Applied DNA Science Inc. (APDN) reported record financial results for the fiscal third quarter of 2012 ended June, 2012.

Total revenue in the quarter ending June 30, 2012 reached $0.53 million, compared to $0.23 million for the third quarter of 2011, an increase of 130%. The increase in revenues was substantially generated from sales of the Company's two leading product lines SigNature® DNA and BioMaterial GenoTyping™, which are the principal anti-counterfeiting and product authentication solutions.

Third quarter of 2012 revenue of $0.53 million also beat our estimate of $0.50 million.

Revenues for the nine-month period have increased by 127% year over year, topping $1.5 million for the first time. This is higher than the Company's prior record revenue in any complete fiscal year.

SG&A expenses increased from $1.6 million for the three months ended June 30, 2011 to $1.8 million for the three months ended June 30, 2012. The increase of $171,713 represents an 11% increase over the same quarter in the prior fiscal year and is primarily attributable to the cost of stock-based compensation incurred in the current period compared to the same period last year.

The Company incurred research and development expenses of $99,958 and $47,988 for the three-month periods ended June 30, 2012 and 2011, respectively. The increase is attributable to additional research and development activity needed with current operations.

Total operating expenses increased to $2.0 million for the three months ended June 30, 2012 from $1.7 million for the three months ended June 30, 2011, an increase of $235,129 quarter over quarter, or 14%.

Net loss dropped to $1.4 million (-$0.00) in the current quarter compared to $2.2 million (-$0.01) in the same quarter of 2011. This is a 34% reduction year over year. Net loss of $1.4 million also beat our estimate of $1.7 million.

Due to its business growth, APDN recently has significantly expanded its office, production, and laboratory space and increased its personnel. The expansion reflects the company's continued worldwide growth in production capacity, technology advancement, and global customer support. Those factors are also seen in a steady rise in shipments of its DNA products.

We are very pleased to see that APDN has achieved another strong quarter for fiscal 2012. The Company began fiscal year 2012 with a strong first quarter with revenue of $0.52 million. Second quarter and third quarter have 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.

While revenue has increased quarter by quarter for the nine months of 2012, SG&A expense has dropped each quarter in the first three quarters of 2012. We are very glad to see revenues increase while expenses are controlled closely.

Sustainable Growth is Supported by Continued New Business Developments

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

On October 9, 2012, APDN announced that **3SI Security Systems** is expanding its use of APDN's SigNature® DNA evidence marking product into 3SI smoke and dye cash protection systems used across Europe. First orders, to the banking sector, are already being processed.

3SI Security Systems is a world leader in cash protection systems designed to recover stolen cash and high-value assets, apprehend criminals and deter crime. The smoke and dye system, called Thinpac™, is already in use in over 130,000 locations worldwide, with great success at deterring crime.

Police forces across Europe are becoming more familiar with the use of unique SigNature DNA markers in cash-protection systems, placing them in a much better position to catch and convict criminals. SigNature DNA provides police with a welcome additional investigative tool, which often reduces the amount of time it takes the police to undertake such investigations.

SigNature DNA is used to protect approximately 26% of cash movements in the United Kingdom.

Protection of bank tellers adds to APDN's portfolio of cash protection products. 3SI already uses APDN SigNature DNA marks to protect nearly 5,000 ATMs, using a DNA liquid which is placed in ink tanks that are fitted inside individual ATM cassettes. The cassette activates when triggered, marking all the cash inside the ATM and the criminals.

On September 18, 2012, APDN announced that it has entered into a Development Agreement with **Inventionland Corporation**. The two companies will collaborate on the development of innovative loss-prevention products, based upon APDN's botanical DNA-marking platform. Inventionland will participate in product development with APDN and take the resultant new products and applications to its customers.

The agreement between APDN and Inventionland follows closely the launch by APDN of smartDNA®, a system designed to mark offenders and to prevent theft. The system has been deployed internationally to protect banks, retailers, jewelers and pharmacies. APDN also launched its digitalDNA platform this year that combines DNA-based security with secure-cloud technology, mobile computing and authentication on-the-fly.

Inventionland Corporation is America's largest invention factory. Over 1,000 different retailers and on-line stores have sold its innovations. Inventionland builds 2,000-2,400 new product samples for corporations and retailers to review for their shelves each year. With some retailers facing large asset loss from their stores, Inventionland was asked to invent new products to help eliminate loss in a more innovative and effective manner. Inventionland's founder, George Davison, is an APDN stockholder. After Mr. Davison contacted APDN, both organizations began collaborating to offer a retailer solution that would help eliminate asset loss.

On September 17, 2012, APDN and the Textile Center of Excellence of United Kingdom (TCOE) announced the roll out of a new platform for protecting textile brands, under the SigNature® DNA brand. The services aim to protect textiles from a wave of counterfeiting which has struck the industry.

The platform includes applications which protect a wide range of textile, apparel and accessory products, including impregnation and authentication of DNA-marked:

- wool yarns
- polyester thread
- cashmere yarns
- fabric selvedge
- woven and non-woven labels

SigNature DNA is a leading anti-counterfeiting technology that can be incorporated at any point in the textile supply chain as a means to link a genuine product to its original source of manufacture. Botanical SigNature DNA markers are authenticated in a laboratory and help to provide forensic evidence that can be used in a court of law.

On September 5, 2012, APDN announced an agreement with SMT Corporation of Sandy Hook, Connecticut (SMT). SMT, the well-known electronics parts distributor, will begin SigNature® DNA marking components that leave its facility.

The agreement between APDN and SMT follows closely on the heels of the mandate by the Defense Logistics Agency that microcircuits supplied to DLA be SigNature DNA-marked. The mandate appeared at an announcement on the DLA Internet Bulletin Board System on August 7.

The agreement comes just as the new federal electronics anti-counterfeiting laws are due to come into effect. In Section 818 of the National Defense Authorization Act for Fiscal Year 2012, the Department of Defense must require suppliers of electronics parts to "monitor and eliminate" counterfeits from the military supply chain. The APDN-SMT agreement is an effort toward early compliance with that law by an important player in the industry.

VALUATION AND RECOMMENDATION

Since our initiation of coverage of APDN in early September, 2010, share price has appreciated from $0.04 then to current $0.18 per share. We encourage investors to take some profit at this point as the price will consolidate for a while at current level. We therefore maintain our Neutral rating on APDN with a new price target of $0.25 per share.

We remain optimistic about APDN's prospect. APDN has achieved strong financial performance and operational achievements in recent quarters as well as positive business developments. We believe top line growth will be further boosted in the coming quarters.

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 huge compound annual growth rate (CAGR) of 127% 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.

We think the Company should trade around a P/E of 30x. 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 $0.25 per share. This values the company at $156 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.

As of June 30, 2012, the Company had only $1.3 million in cash and cash equivalents. Current cash can last one quarter. We believe APDN needs to tap the capital market very soon, and will do so on a regular basis.

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 627 million at the end of June 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.

Another concern comes from APDN's revenue concentration. An aggregate of 59% of the Company's revenue was earned from two customers for the third quarter of 2012, while one customer accounted for 46% of the Company's total revenues for the nine months ending June 30, 2012.

PROJECTED INCOME STATEMENT

	2011A (Sep)					2012E (Sep)					2013E (SEP)	2014E (Sep)	2015E (Sep)
$ in million except per share data	Q1	Q2	Q3	Q4	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE
Total Revenues	**$0.32**	**$0.14**	**$0.23**	**$0.28**	**$0.97**	**$0.52**	**$0.52**	**$0.53**	**$0.54**	**$2.10**	**$5.50**	**$10.00**	**$24.50**
YOY Growth	*337.1%*	*-25.0%*	*35.0%*	*213.1%*	*86.3%*	*62.6%*	*269.1%*	*130.1%*	*90.6%*	*116.7%*	*162.0%*	*81.8%*	*145.0%*
CoGS	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	**0.30**	**0.13**	**0.23**	**0.28**	**0.97**	**0.52**	**0.52**	**0.53**	**0.54**	**2.10**	**4.97**	**9.04**	**22.14**
Gross Margin	*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	$1.3	$1.6	$1.6	$3.9	$8.4	$2.2	$1.8	$1.8	$1.8	$7.5	$8.5	$9.0	$11.0
% SG&A	*411.9%*	*1143.0%*	*688.2%*	*1387.3%*	*866.0%*	*416.4%*	*352.0%*	*331.6%*	*336.4%*	*358.7%*	*154.5%*	*90.0%*	*44.9%*
R&D	$0.02	$0.09	$0.05	$0.11	$0.27	$0.08	$0.10	$0.10	$0.10	$0.37	$0.35	$0.37	$0.40
% R&D	*6.5%*	*66.2%*	*20.9%*	*38.2%*	*27.8%*	*15.2%*	*18.5%*	*18.9%*	*18.7%*	*17.8%*	*6.4%*	*3.7%*	*1.6%*
Other	$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	*29.2%*	*65.4%*	*40.0%*	*32.4%*	*37.9%*	*19.0%*	*19.0%*	*19.6%*	*18.7%*	*19.1%*	*7.3%*	*4.0%*	*1.2%*
Operating Income	**($1.1)**	**($1.7)**	**($1.5)**	**($3.8)**	**($8.1)**	**($1.8)**	**($1.5)**	**($1.4)**	**($1.5)**	**($6.2)**	**($4.3)**	**($0.7)**	**$10.4**
Operating Margin	*-354.0%*	*-1184.6%*	*-649.1%*	*-1357.9%*	*-835.3%*	*-350.6%*	*-289.6%*	*-270.0%*	*-273.8%*	*-295.7%*	*-77.8%*	*-7.3%*	*42.6%*
Other Net	($0.2)	($0.9)	($0.7)	($0.6)	($2.5)	($0.6)	($0.1)	($0.0)	($0.1)	($0.7)	($1.0)	($1.0)	($1.0)
Pre-Tax Income	**($1.3)**	**($2.6)**	**($2.2)**	**($4.5)**	**($10.5)**	**($2.4)**	**($1.6)**	**($1.4)**	**($1.5)**	**($6.9)**	**($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
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%*
Reported Net Income	**($1.3)**	**($2.6)**	**($2.2)**	**($4.5)**	**($10.5)**	**($2.4)**	**($1.6)**	**($1.4)**	**($1.5)**	**($6.9)**	**($5.3)**	**($1.7)**	**$9.4**
YOY Growth	-	-	-	-	-	-	-	-	-	-	*-23.8%*	*-67.2%*	*-644.5%*
Net Margin	*-422.9%*	*-1850.3%*	*-938.1%*	*-1586.1%*	*-1089.1%*	*-466.2%*	*-301.1%*	*-270.5%*	*-285.0%*	*-330.0%*	*-96.0%*	*-17.3%*	*38.5%*
Shares Out	*349.2*	*351.4*	*352.0*	*455.0*	*376.9*	*490.3*	*583.6*	*594.9*	*627.0*	*574.0*	*650.0*	*700.0*	*750.0*
Reported EPS	**($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	-	-	-	-	-	-	-	-	-	-	*-32.7%*	*-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*
Non GAAP Net Income	**($1.3)**	**($2.6)**	**($2.2)**	**($4.5)**	**($10.5)**	**($2.4)**	**($1.6)**	**($1.4)**	**($1.5)**	**($6.9)**	**($5.3)**	**($1.7)**	**$9.4**
Non GAAP EPS	**($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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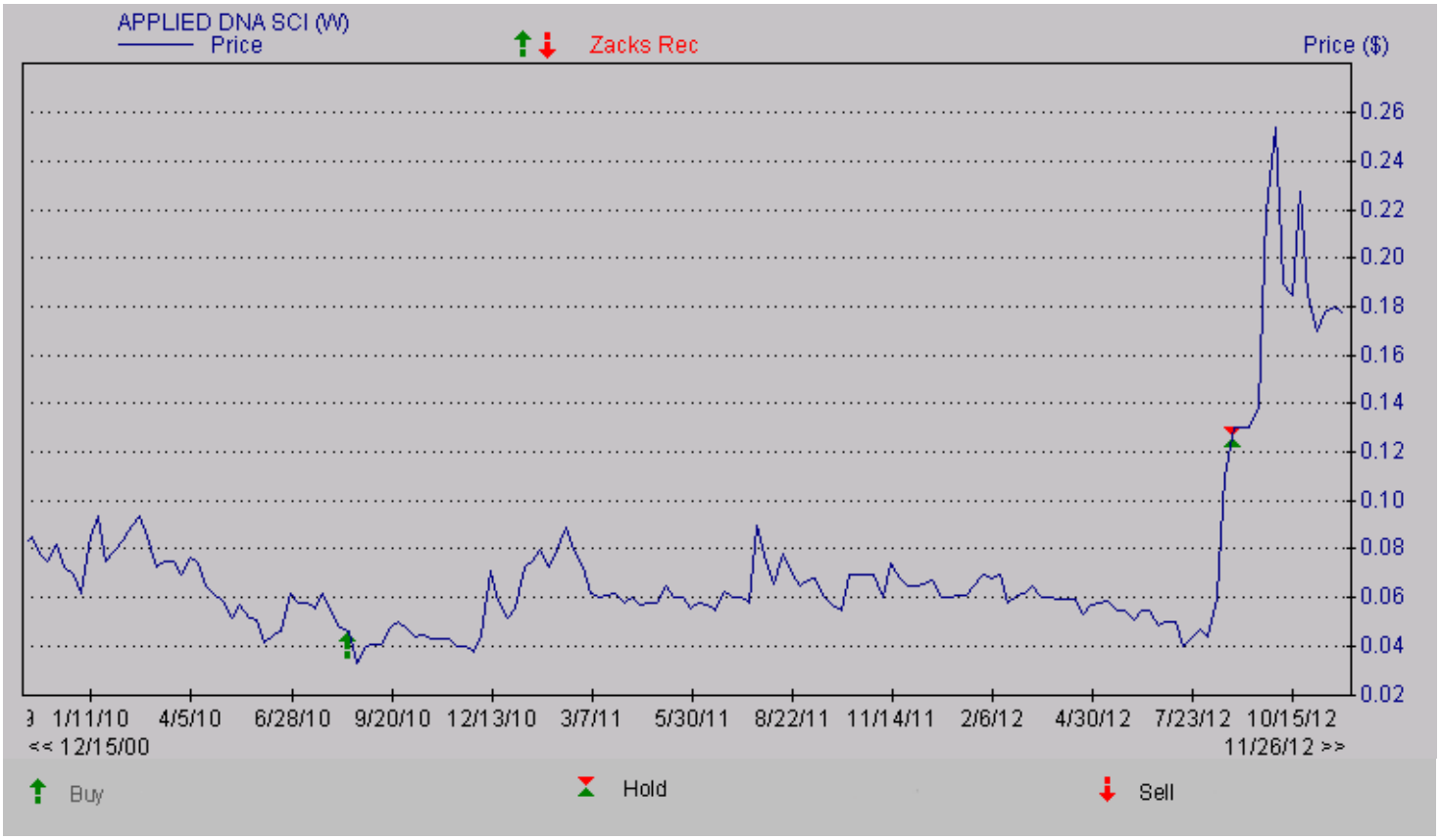
HISTORICAL ZACKS RECOMMENDATIONS



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