Zacks Small-Cap Research

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Applied DNA Sciences (APDN-OTC)

APDN: Record sales reported in fiscal third quarter and businesses continue to grow--- Outperform

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	08/21/2013
Current Price (08/21/13)	$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 record sales in fiscal 3Q13 and growth will continue in second half of the year.

SUMMARY DATA

52-Week High	**$0.29**
52-Week Low	**$0.11**
One-Year Return (%)	**-5.00**
Beta	**1.35**
Average Daily Volume (sh)	**3,575,993**
Shares Outstanding (mil)	**733**
Market Capitalization ($mil)	**$97**
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	0.34 A	0.64 A	0.70 E	2.01 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 A	-$0.00 A	-$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

- APDN reported record sales in fiscal third quarter of 2013;
- Balance sheet boosted by recent financing;
- Top line will continue to grow in 2H13 and beyond;
- We upgrade APDN shares to Outperform from Neutral;

APDN reports record sales for the fiscal third quarter

On Aug 13, 2013, Applied DNA Sciences (APDN) announced its financial results for the third fiscal quarter ending June 30, 2013.

For the three months ended June 30, 2013, APDN generated $644,842 in revenues from operations, an increase of $116,268, or 22%, from revenue of $528,574 for the three months ended June 30, 2012. Revenues for the three months ended June 30, 2013 were principally from the sales of authentication services. The increase in sales for the three months ended June 30, 2013 compared to the three months ended June 30, 2012 was primarily caused by the increase in DNA-marking contracts with commercial electronics manufacturers and represents the company's highest quarterly revenues to date.

Selling, general and administrative (SG&A) expenses increased from $1,752,501 for the three months ended June 30, 2012 to $3,240,815 for the three months ended June 30, 2013. The increase of $1,488,314, or 84.9%, is primarily attributable to higher professional fees specifically for legal and consulting and increased salary due to the increased headcount. The increase is also due to expenses incurred for the relocation of the company's corporate office during the three months ended June 30, 2013. Included in SG&A for the three months ended June 30, 2013 is approximately $956,000 of non-cash charges, including $886,000 for stock based compensation expense primarily related to the vesting and modification of employee stock options and $70,000 of bad debt expense.

Research and development expenses increased from $99,958 for the three months ended June 30, 2012 to $184,981 for the three months ended June 30, 2013. The increase of $85,023 or 85.1% is attributable to additional research and development to extend the company's patent portfolio and to capitalize on emerging market requests.

Net loss for the three months ended June 30, 2013 increased to $2,135,612 from a net loss of $1,429,645 for the three months ended June 30, 2012 due to increased SG&A and R&D expenses.

We are impressed by the strong financial performance for the fiscal third quarter of 2013. APDN reported record revenue in the company's history. This quarter, APDN signed eight contracts related to Federal Supply Class (FSC) 5962, doubling the cumulative contracts that had been signed by the previous quarter. Management anticipates this trend will continue, judging from the increasing number of inquiries and companies in various stages of negotiation.

Since the company has completed the move into new facility, SG&A expenses will stabilize going forward. APDN is positioned to deliver against high demand while continuing necessary product development without additional major expenditures.

Balance sheet boosted by recent financing

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 June 30, 2013, APDN had $1.8 million in cash. With the $7.5 million new financing, the company’s cash balance should be able to last into fiscal 1Q15.

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.

Top line will continue to grow in 2H13 and beyond

With record sales reported for the three months ended June 30, 2013, we believe revenue growth will accelerate in the second half of the calendar 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 first half of the fiscal year 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.

The electronics industry is vast. The companies signed or in stages of negotiation include manufacturers, authorized distributors, and prime contractors. The company also reported favorably on its high profile in the area of new government regulations requiring defense suppliers to build anti-counterfeiting systems. APDN team members have presented at scores of conferences, led a major industry workshop this quarter, and delivered formal comments at hearings in Washington D.C. and in written form, all as thought leaders on anti-counterfeiting in electronics. Coverage of the company in trade and mass media has been extensive.

In the last quarter, APDN has expanded its Distribution network to increase sales of its off-the-shelf products such as the Sentry DNA spray system. This action has shown additional sales revenue at minimal operational costs. APDN now has distributors in Sweden, Italy, Australia, New Zealand, North America, Greece and the Middle East, with plans for further expansion.

Contract with the Missile Defense Agency (MDA) is ahead of schedule. For example, execution against the company's technology roadmap has led to increases in scale needed to penetrate industry sectors from independent distributors, to authorized distributors, to component manufacturers and prime contractors. The company expects corresponding increments in scale for printing and marking methodologies to be relevant to multiple industries and federal agencies.

APDN is engaged with the London Metropolitan Police Service (MPS), deploying its DNANet product against home burglaries in two of the city's high-crime areas, Southwark and Lambeth. Results have been very favorable, including in districts adjacent to the target neighborhoods, showing that crime has not been merely displaced, but deterred.

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.

The Company's **cash-in-transit business** is holding steady with positive signs of potential growth, while its **textile business** is completing global pilots and with the recent announcements of the RedWeb Asset acquisition and SmokeCloak collaboration, APDN's **security business** throughout the world is poised for expansion -- both in breadth and depth.

The **copper theft business** is also showing positive sign of growth. Copper theft is a global scourge that can damage a country's critical infrastructure. In the last 6 months APDN has had a substantial order to protect a European electrical utility. Swedish railways have marked miles of copper with APDN's DNA. Recently, American rail systems have shown similar interests. Given the size and scope of the copper market and the scale of copper crime combined with its threat to critical infrastructure, we expect the DNA marking of copper to become an important market for APDN.

Based on all these developments, we model the Company's top line will continue to grow in the second half of this calendar year. Total revenue for fiscal 2013 will reach $2.01 million.

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 Aug 6, 2013, APDN announced that it has rolled out high-volume, high-throughput SigNature® DNA-marking technology geared to the biggest firms in the electronics industry, including manufacturers and prime contractors to the U.S. Defense Department.

The firm's partners are being trained in the mass-application process known as pad printing, ultraviolet (UV) curing, and in other techniques supporting massive production flows. UV curing, for example, typically adheres the uncopyable SigNature DNA marks to components in seconds. The UV process lends itself to marking delicate / sensitive components without direct handling of the parts themselves during the marking or curing process, a condition stipulated by several primes.

The new steps are part of APDN's platform scalability plans, which it terms its Technology Road Map. The Road Map shows the company's plans to scale and add to its capability as its customer base grows and changes.

Company officials pointed out that APDN partner SMT Corporation has now implemented the new technologies in dedicated facilities for SigNature DNA marking of electronics. Security, quarantine, and test facilities have also been ramped up to support the SigNature DNA marking and authentication platform.

On Aug 2, 2013, APDN announced that its SigNature DNA mark has been used to protect nearly 500,000 electronics parts in the combined outcome of its pilots and contracts, an effort driven by the U.S.

Defense Logistics Agency (DLA) against the infiltration of counterfeit electronic parts. Seventeen companies are actively marking microcircuits with SigNature DNA, a requirement set out by DLA for companies providing a class of microcircuits to the Agency. Overall, fifty-one companies are signed or in various stages of negotiation.

Company officials pointed out that the rate of new contract signings had increased significantly; of the companies actively using SigNature DNA marking, 35% had signed on in the last two months. Customers now include both authorized distributors and manufacturers, including the first two companies known as "QMLs," meaning that they are included on DLA's highly selective Qualified Manufacturers List.

On July 11, 2013, APDN announced that its ongoing staff expansion has so far resulted in a 72% increase in scientific, quality, operational and other employees since January of the current year. The company now counts **forty-eight** staff in Stony Brook, NY, United Kingdom, and elsewhere. The expansion accommodates the company's worldwide growth, including a broader product array, and a growing sales pipeline. A more robust and larger plant is in place to support the expansion.

Company officials pointed to increasing number of contracts with suppliers of military electronics, a total of sixteen as of July 11, and calls for anti-theft assets, including those acquired from United Kingdom-based RedWeb Technologies, as examples of the increased demand.

The company has moved into a new, 30,000 square foot building, with significantly larger and differentiated laboratory space, improved security arrangements, new staging, shipping and fulfillment centers, and an expanded front office.

On May 15, 2013, the Company entered into an Asset Purchase Agreement with **RedWeb Technologies** Limited, a corporation incorporated and registered under the laws of England & Wales, to purchase certain assets of RedWeb relating to its forensic tagging security system for a purchase price of £400,000 ($624,080). The Purchased Assets include RedWeb's Sentry 500 Intruder Spray System, RedWeb's Advanced Molecular Taggent Technology and all products relating thereto, certain intellectual property and inventory relating to the foregoing.

The deal will provide APDN with synergistic products once the RedWeb products have been further developed. The eventual result will be complementarity between the delivery systems and the two forensic marking systems. The transaction also provides APDN with a platform for further growth and expansion of its global customer list.

On May 15, 2013, APDN has entered into a 2-way exclusive agreement with **SmokeCloak, A/S** (MSS) of Denmark, to market a technology combining APDN's SigNature DNA in a rapid-deployment security smoke called DNA Fog. MSS will buy DNA only from APDN, while APDN will supply DNA to no other fog manufacturer than SmokeCloak. As part of the relationship, MSS has extended their distribution network for use by APDN, accessing security sales throughout the world and enhancing APDN's internal sales force.

The combination of SmokeCloak’s room-filling smoke generators together with APDN’s anti-intruder device, which produces a targeted spray directed at the suspect, will give both companies a strong competitive edge in the crime deterrent market.

On April 4, 2013, APDN announced the signing of a Letter of Intent (LOI) with **Markem-Imaje** Corporation, establishing Applied DNA Sciences as an authorized reseller of Markem-Imaje Fluid inks. The LOI is specifically related to the application of SigNature DNA botanical markers added into Markem-Imaje inks. This supports suppliers in meeting the Defense Logistics Agency (DLA) requirement for SigNature DNA marking on a class of electronics provided to the Agency. Markem-Imaje is a top supplier of inks to the electronics industry, both military and commercial, and is said to be the world's largest provider of product identification solutions.

Valuation is again attractive now

We are upgrading our rating for APDN to Outperform from previous Neutral and our 12-month price target is $0.25 per share.

Apparently, first half of the fiscal year 2013 financials were disappointing. Revenue for the first two fiscal quarters was down 39% and 34%, respectively. But as we pointed in our previous report we believe revenue will resume growth in the second half of this fiscal year due to the focused marketing efforts management has put in place.

This was exactly the case for fiscal third quarter ended June 30, 2013. APDN reported record sales of $0.64 million for the fiscal third quarter, an increase of 22% year over year. We believe this trend will continue in fiscal fourth quarter. We estimate revenue for fiscal 2013 will cross the mark of $2.0 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 in our view.

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 88% 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.

APDN is a high growth company. In terms of valuation, we think the Company should trade between a P/E of 45x. We apply a P/E of 45x to our estimated EPS of $0.01 in fiscal 2017, discounted at 20% for 3 years, we get our price target of $0.25 per share. This values the company at about $183 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.

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 733 million at the end of June, 2013. 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**	**$0.34**	**$0.64**	**$0.70**	**$2.01**	**$5.50**	**$12.50**	**$17.50**	**$25.00**
YOY Growth	*62.6%*	*269.1%*	*130.1%*	*3.6%*	*91.5%*	*-38.5%*	*-33.5%*	*22.0%*	*140.7%*	*8.2%*	*174.0%*	*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**	**0.34**	**0.64**	**0.70**	**2.01**	**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	$2.8	$3.2	$2.9	$11.4	$12.0	$12.5	$13.0	$14.0
% SG&A	*416.4%*	*352.0%*	*331.6%*	*648.6%*	*410.6%*	*793.6%*	*799.3%*	*502.6%*	*414.3%*	*568.8%*	*218.2%*	*100.0%*	*74.3%*	*56.0%*
R&D	$0.08	$0.10	$0.10	$0.16	$0.43	$0.15	$0.18	$0.18	$0.18	$0.69	$0.75	$0.90	$1.10	$1.25
% R&D	*15.2%*	*18.5%*	*18.9%*	*54.4%*	*23.3%*	*46.5%*	*51.2%*	*28.7%*	*25.7%*	*34.3%*	*13.6%*	*7.2%*	*6.3%*	*5.0%*
Other	$0.1	$0.1	$0.1	$0.0	$0.3	$0.0	$0.0	$0.1	$0.1	$0.2	$0.4	$0.3	$0.3	$0.3
% Other	*19.0%*	*19.0%*	*19.6%*	*4.6%*	*16.9%*	*6.6%*	*6.3%*	*9.7%*	*14.3%*	*10.2%*	*7.3%*	*2.4%*	*1.7%*	*1.2%*
Operating Income	**($1.8)**	**($1.5)**	**($1.4)**	**($1.8)**	**($6.5)**	**($2.4)**	**($2.6)**	**($2.8)**	**($2.5)**	**($10.3)**	**($7.7)**	**($1.2)**	**$3.1**	**$9.5**
Operating Margin	*-350.6%*	*-289.6%*	*-270.0%*	*-607.6%*	*-350.9%*	*-746.7%*	*-756.8%*	*-440.9%*	*-354.3%*	*-513.3%*	*-139.1%*	*-9.6%*	*17.7%*	*37.8%*
Other Net	($0.6)	($0.1)	($0.0)	$0.0	($0.6)	($6.3)	($0.5)	$0.7	$0.0	($6.1)	($1.0)	($1.0)	($1.0)	($1.0)
Pre-Tax Income	**($2.4)**	**($1.6)**	**($1.4)**	**($1.8)**	**($7.2)**	**($8.7)**	**($3.1)**	**($2.1)**	**($2.5)**	**($16.4)**	**($8.7)**	**($2.2)**	**$2.1**	**$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)**	**($3.1)**	**($2.1)**	**($2.5)**	**($16.4)**	**($8.7)**	**($2.2)**	**$2.1**	**$8.5**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	-	-	*302.38%*
Net Margin	*-466.2%*	*-301.1%*	*-270.5%*	*-601.8%*	*-385.5%*	*-2740.2%*	*-907.6%*	*-331.2%*	*-354.3%*	*-819.5%*	*-157.3%*	*-17.6%*	*12.0%*	*33.8%*
Shares Out	*490.3*	*583.6*	*594.9*	*635.5*	*576.1*	*649.9*	*680.4*	*721.1*	*733.0*	*696.1*	*800.0*	*870.0*	*940.0*	*1000.0*
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	-	-	-	-	-	-	-	-	-	-	-	-	-	*278.2%*
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)**	**($3.1)**	**($2.1)**	**($2.5)**	**($10.1)**	**($8.7)**	**($2.2)**	**$2.1**	**$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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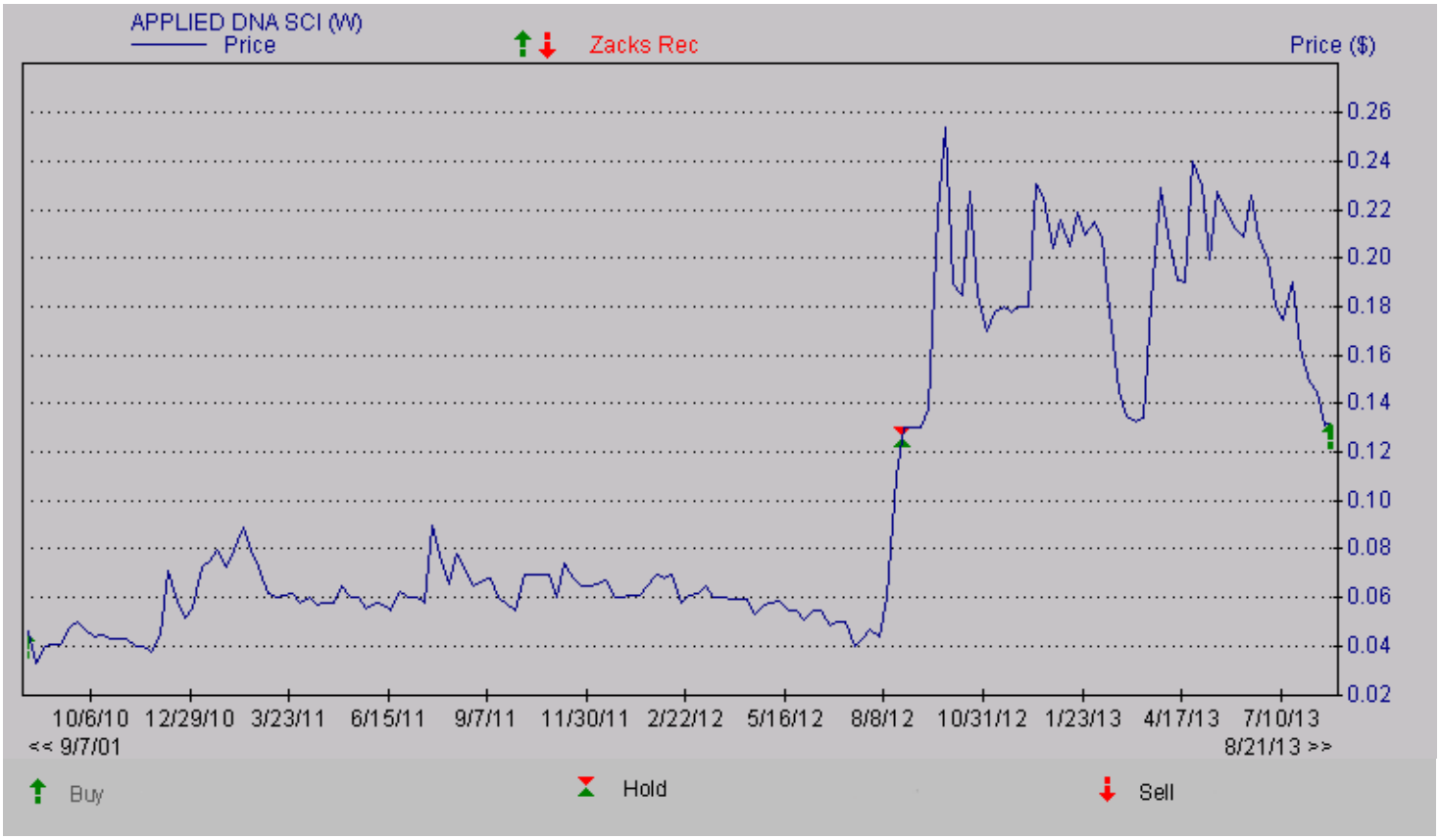
HISTORICAL ZACKS RECOMMENDATIONS



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