Zacks Small-Cap Research

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Applied DNA Sciences (APDN-OTC)

APDN: 1Q14 revenue increased by 88%, highest revenue for first quarter in the company's history; balance sheet remained strong, businesses continue to grow--Outperform

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	08/21/2013
Current Price (02/10/14)	$0.16
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 88% increase in 1Q14. We expect to see further growth of revenue in fiscal 2014 and beyond.

SUMMARY DATA

52-Week High	**$0.26**
52-Week Low	**$0.09**
One-Year Return (%)	**-22.93**
Beta	**1.38**
Average Daily Volume (sh)	**1,650,703**
Shares Outstanding (mil)	**808**
Market Capitalization ($mil)	**$129**
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	0.80 E	0.95 E	1.05 E	3.40 E
2015					7.50 E
2016					15.00 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 E	-$0.00 E	-$0.00 E	-$0.01 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 88% year over year in fiscal 1Q14;
- Balance sheet remained strong;
- Business continues to grow;
- Maintain Outperform rating for APDN shares;

Record Revenue Reported for Fiscal 4Q, and For Fiscal 2013

On February 11, Applied DNA (APDN) announced financial results for the fiscal 1Q14 ending December 31, 2-13.

Revenue was $597,354 for the first fiscal quarter of 2014 compared with $317,670 for the fiscal quarter of 2013, an **increase of 88%.** The revenue growth was primarily due to increases in sales to suppliers of the United States Defense Logistics Agency (DLA) and in the textile industry. Revenue for 1Q14 represents the highest first quarter in the Company's history.

Research and development expenses were $459,304 for the 1Q14 ended December 31, 2013 compared to $147,666 for the 1Q13. The increase was attributable to the increased laboratory space with the company's new corporate headquarters as well as an increase in research and development to support the expansion of its business and markets. In particular, Applied DNA has multiple work streams in progress toward a launch of new products for field detection of SigNature DNA and the reading of optical marks which use the SigNature DNA ingredient.

Operating expenses were $4.4 million for 1Q14 compared with $2.7 million for 1Q13. According to management, the increase was primarily attributable to higher salary expense due to an increase in employee headcount from 29 as of December 31, 2012 to 49 as of December 31, 2013. The increase in the number of employees was in production, sales, information technology and finance, to meet the anticipated future demand for sales.

Loss from operations for 1Q14 was $3,812,743 compared with $2,372,158 in 1Q13.

Loss from change in fair value of warrant liability during the three months ended December 31, 2013 and 2012 was $2,634,758 and $6,332,599, respectively. These non-cash losses represent the change in fair value for the respective reporting period for our warrants that are classified as liabilities.

Net loss for 1Q14 decreased to $6,291,650 or $0.01 per share from a net loss of $8,704,757 or $0.01 per share in first fiscal quarter of 2013.

We think this was a strong quarter for APDN in terms of financial performance. APDN reported highest first quarter sales in the company's history.

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. 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.

At the end of December 31, 2013, APDN held $4.2 million in cash and cash equivalents. As of December 31, 2013, working capital was $3.5 million. According to our model, the company’s current cash balance and working capital as of December 31, 2013 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:

APDN renewed three contracts and initiated four new contracts with DLA suppliers, compared to three contracts executed during the quarter ended December 31, 2012. To date, twenty eight (28) customers in the Military Electronics Anti-counterfeiting Program, including seven Original Component Manufacturers (OCMs) and two electronics distributors have signed and/or renewed agreements.

During the quarter, APDN singed an exclusivity and marking agreement with a wool consolidator and manufacturer.

The company rolled out **SigNature(R) T**, a new security platform specifically for textiles and apparel. The new DNA-based platform has been made possible by a proprietary breakthrough technology, recently developed by the Company to identify textile raw materials as well as finished products.

APDN initiated collaboration with **Supima(R),** a non-profit trade association of the American Pima cotton growers, to mark, identify, and protect 100% U.S. grown American Pima, one of the most desirable luxury cotton fibers in the world, from counterfeiting and blending. Begun in November, SigNature(R) T has been used to mark millions of kilograms of cotton at a major cotton grower.

In December 2013, APDN announced the success of a large-scale international trial of SigNature(R) T anti-counterfeiting platform to assure identity and originality of textiles and apparel. The trial, in collaboration with one of the world's foremost textile organizations, displayed the capacity of the APDN platform for use in protecting massive cotton crops from counterfeiting and dilution.

During 1Q14, APDN announced the launch of a new turnkey program for electronics, military, commercial, and aerospace contractors called the Counterfeit Prevention Authentication Program (CPA Program). The program empowers end-users to verify the originality or provenance of parts which have been marked by their suppliers with APDN's SigNature(R) DNA.

APDN also announced the availability of an additional version of its SigNature(R) DNA mark for electronic components, for use exclusively by authorized distributors. A unique mark, specifically identifying that authorized distributor, is to be applied to incoming components, or legacy inventory before shipment per customer request. From that point forward, the marked components will be absolutely identifiable as sourced from the authorized channel.

Other business development achievements during the quarter included expansion of cash in transit business to include Poland. Distributors are offering the company's DNANet(R) products in Sweden, Germany, Austria, Greece, Italy, Australia, and New Zealand. APDN received Notice of Allowance for one patent offering increased protection in the textiles market vertical; currently there are 22 issued patents and 31 patents pending.

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.

Valuation is Attractive

We maintain our Outperform rating for APDN shares and reiterate our 12-month price target of $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 the second half of 2013. APDN reported record sales of $0.64 million and $0.73 million for the fiscal third quarter and fourth quarter respectively, an increase of 22% and 151% year over year respectively. Revenue for fiscal 2013 crossed the mark of $2.0 million.

Revenue continued to grow in 1Q14. The company reported 88% increase in revenue for the fiscal first quarter of 2014 ended December 31, 2013, which represented the highest first quarter revenue ever in the company's history.

Balances sheet has been boosted by recent financing, which 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 87% in the four fiscal years from 2013 to 2017. The Company will 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 at 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 $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 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 808 million at the end of December 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.

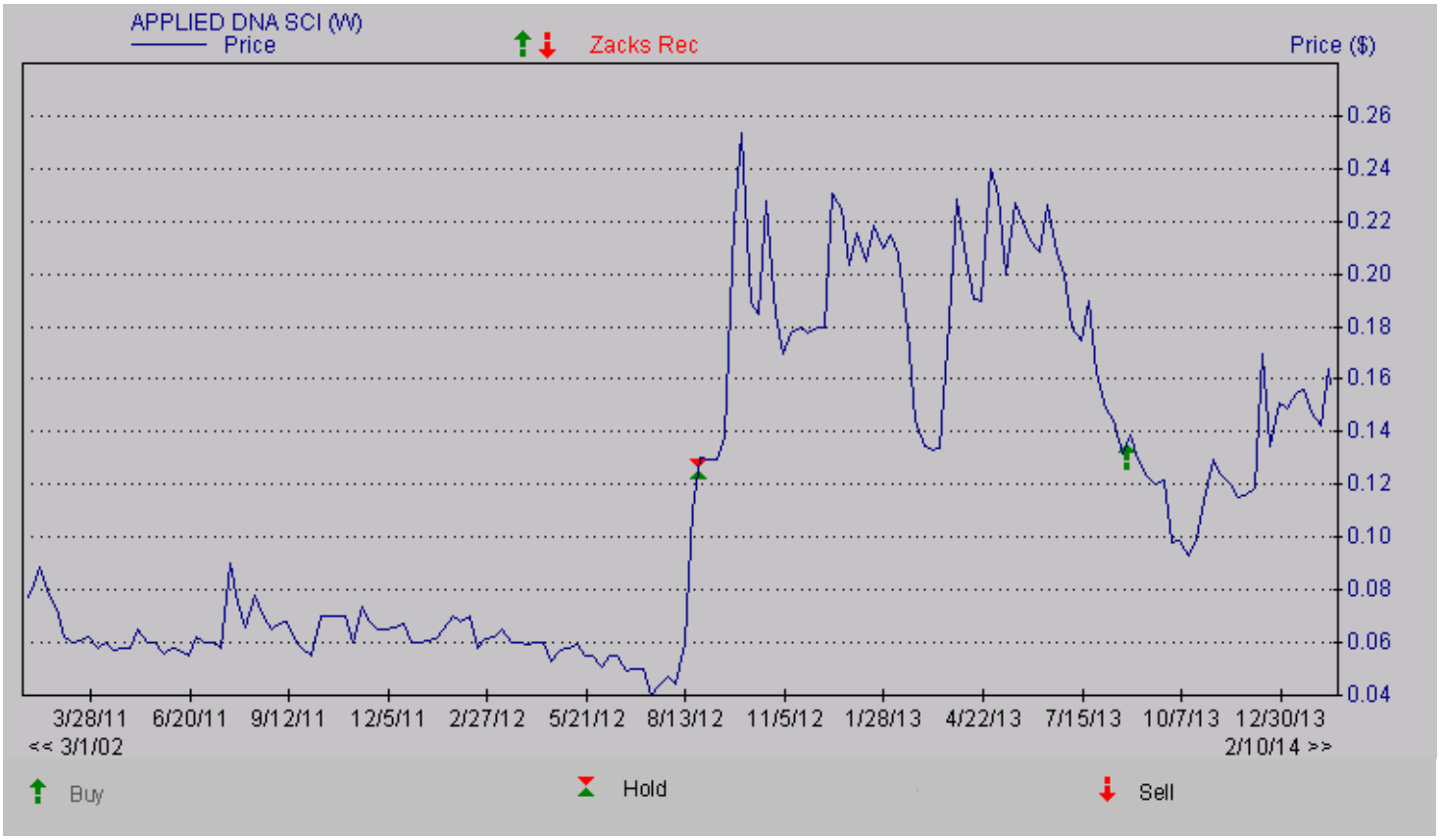
PROJECTED INCOME STATEMENT

	2011A (Sep)	2012A (Sep)	2013E (Sep)					2014E (Sep)					2015E (Sep)	2016E (Sep)	2017E (Sep)
$ in million except per share data	FYA	FYA	Q1	Q2	Q3	Q4	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE
Total Revenues	**$0.97**	**$1.85**	**$0.32**	**$0.34**	**$0.64**	**$0.73**	**$2.04**	**$0.60**	**$0.80**	**$0.95**	**$1.05**	**$3.40**	**$7.50**	**$15.00**	**$25.00**
YOY Growth	*86.3%*	*91.5%*	*-38.5%*	*-33.5%*	*22.0%*	*150.7%*	*9.8%*	*88.0%*	*132.1%*	*47.3%*	*44.0%*	*66.8%*	*120.8%*	*100.0%*	*66.7%*
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
Gross Income	**0.97**	**1.85**	**0.32**	**0.34**	**0.64**	**0.73**	**2.04**	**0.60**	**0.80**	**0.95**	**1.05**	**3.40**	**7.50**	**15.00**	**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%*	*100.0%*
SG&A	$8.4	$7.6	$2.5	$2.8	$3.2	$2.7	$11.2	$3.8	$2.9	$3.0	$3.1	$12.8	$13.0	$13.5	$14.0
% SG&A	*866.0%*	*410.6%*	*793.6%*	*799.3%*	*502.6%*	*367.9%*	*550.0%*	*643.8%*	*362.5%*	*315.8%*	*295.2%*	*378.1%*	*173.3%*	*90.0%*	*56.0%*
R&D	$0.27	$0.43	$0.15	$0.18	$0.18	$0.18	$0.69	$0.46	$0.30	$0.30	$0.30	$1.36	$1.40	$1.50	$1.25
% R&D	*27.8%*	*23.3%*	*46.5%*	*51.2%*	*28.7%*	*25.1%*	*34.0%*	*76.9%*	*37.5%*	*31.6%*	*28.6%*	*40.0%*	*18.7%*	*10.0%*	*5.0%*
Other	$0.4	$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
% Other	*37.9%*	*16.9%*	*6.6%*	*6.3%*	*9.7%*	*29.6%*	*15.8%*	*17.6%*	*12.5%*	*10.5%*	*9.5%*	*11.9%*	*4.0%*	*2.0%*	*1.2%*
Operating Income	**($8.1)**	**($6.5)**	**($2.4)**	**($2.6)**	**($2.8)**	**($2.4)**	**($10.2)**	**($3.8)**	**($2.5)**	**($2.5)**	**($2.5)**	**($11.2)**	**($7.2)**	**($0.3)**	**$9.5**
Operating Margin	*-835.3%*	*-350.9%*	*-746.7%*	*-756.8%*	*-440.9%*	*-322.6%*	*-499.7%*	*-638.3%*	*-312.5%*	*-257.9%*	*-233.3%*	*-330.0%*	*-96.0%*	*-2.0%*	*37.8%*
Other Net	($2.5)	($0.6)	($6.3)	($0.5)	$0.7	($1.4)	($7.5)	($2.5)	($0.3)	($0.3)	($0.3)	($3.2)	($1.0)	($1.0)	($1.0)
Pre-Tax Income	**($10.5)**	**($7.2)**	**($8.7)**	**($3.1)**	**($2.1)**	**($3.7)**	**($17.7)**	**($6.3)**	**($2.8)**	**($2.7)**	**($2.7)**	**($14.4)**	**($8.2)**	**($1.3)**	**$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	$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%*
Reported Net Income	**($10.5)**	**($7.2)**	**($8.7)**	**($3.1)**	**($2.1)**	**($3.7)**	**($17.7)**	**($6.3)**	**($2.8)**	**($2.7)**	**($2.7)**	**($14.4)**	**($8.2)**	**($1.3)**	**$8.5**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	-	-	-	*-750.00%*
Net Margin	*-1089.1%*	*-385.5%*	*-2740.2%*	*-907.6%*	*-331.2%*	*-510.0%*	*-868.6%*	-	-	-	-	-	-	-	*33.8%*
Shares Out	*376.9*	*576.1*	*649.9*	*680.4*	*721.1*	*763.9*	*703.9*	*789.9*	*796.0*	*806.0*	*825.0*	*804.2*	*870.0*	*940.0*	*1000.0*
Reported EPS	**($0.03)**	**($0.01)**	**($0.01)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.03)**	**($0.01)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.02)**	**($0.01)**	**($0.00)**	**$0.01**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	-	-	-	*-711.0%*
One time charge	*$0.00*	*$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*
Non GAAP Net Income	**($10.5)**	**($7.2)**	**($2.4)**	**($3.1)**	**($2.1)**	**($3.7)**	**($11.4)**	**($3.7)**	**($2.8)**	**($2.7)**	**($2.7)**	**($11.8)**	**($8.2)**	**($1.3)**	**$8.5**
Non GAAP EPS	**($0.03)**	**($0.01)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.00)**	**($0.02)**	**($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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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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