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APPLIED DNA SCIENCES INC  
Form 10KSB  
January 16, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-KSB

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the Fiscal Year Ended September 30, 2006

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 002-90539

APPLIED DNA SCIENCES, INC.  
(Exact name of small business issuer as specified in its charter)

Nevada	59-2262718
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

25 Health Sciences Drive, Suite 113		
Stony Brook, New York	11790	(631) 444-6862
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(Address of principal executive office)	(Postal Code)	(Issuer's telephone number)

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act: None

Check whether the issuer is not required to file reports pursuant to Section 13  
or 15(d) of the Exchange Act ☐

Check whether the issuer (1) filed all reports required to be filed by Section  
13 or 15(d) of the Exchange Act of 1934 during the past 12 months (or for such  
shorter period that the registrant was required to file such reports), and (2)  
has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Check if there is no disclosure of delinquent filers in response to Item 405 of  
Regulation S-B contained in this form, and no disclosure will be contained, to  
the best of registrant's knowledge, in definitive proxy or information  
statements incorporated by reference in Part III of this Form 10-KSB or any  
amendment to this Form 10-KSB. ☒

Indicate by checkmark whether the registrant is a shell company (as defined by  
Rule 12b-2 of the Exchange Act).  
Yes ☐ No ☒

State issuer's revenues for its most recent fiscal year. \$18,900.

The aggregate market value of the voting and non-voting common equity held by  
non-affiliates was \$10.6 million, as computed by reference to the last sale  
price of the Company's Common Stock, as reported by the OTC Bulletin Board, on

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January 11, 2007.

As of December 29, 2006, the Company had outstanding 121,162,385 shares of Common Stock.

## APPLIED DNA SCIENCES, INC.

### FORM 10-KSB

For the Fiscal Year Ended September 30, 2006

Part I	Page
Item 1. Description of Business.	3
Item 2. Description of Property.	15
Item 3. Legal Proceedings.	15
Item 4. Submission of Matters to a Vote of Security Holders.	16
Part II	Page
Item 5. Market for Common Equity and Related Stockholder Matters.	16
Item 6. Management's Discussion and Analysis or Plan of Operation.	17
Item 7. Financial Statements	32
Item 8. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure.	33
Item 8A. Controls and Procedures.	33
Item 8B. Other Information.	33
Part III	Page
Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act.	34
Item 10. Executive Compensation.	36
Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	37
Item 12. Certain Relationships and Related Transactions.	40
Item 13. Exhibits.	41
Item 14. Principal Accountant Fees and Services.	44
Signatures.	45

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## PART I

### Forward-looking Information

This Annual Report on Form 10-KSB (including the section regarding Management's Discussion and Analysis of Financial Condition and Results of Operations) contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, including statements using terminology such as "can", "may", "believe", "designated to", "will", "expect", "plan", "anticipate", "estimate", "potential" or "continue", or the negative thereof or other comparable terminology regarding beliefs, plans, expectations or intentions regarding the future. You should read statements that contain these words carefully because they:

- o discuss our future expectations;
- o contain projections of our future results of operations or of our financial condition; and
- o state other "forward-looking" information.

We believe it is important to communicate our expectations. However, forward looking statements involve risks and uncertainties and our actual results and the timing of certain events could differ materially from those discussed in forward-looking statements as a result of certain factors, including those set forth under "Risk Factors," "Business" and elsewhere in this prospectus. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to us as of the date thereof, and we assume no obligations to update any forward-looking statement or risk factor, unless we are required to do so by law.

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended, which requires us to file reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). Such reports, proxy statements and other information may be inspected at public reference facilities of the SEC at 100 F Street, N.E., Washington, D.C. 20549. Copies of such material can be obtained from the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549 at prescribed rates. Because we file documents electronically with the SEC, you may also obtain this information by visiting the Securities SEC's website at <http://www.sec.gov>.

### ITEM 1. DESCRIPTION OF BUSINESS.

#### Corporate History

We are a Nevada corporation, which was initially formed under the laws of the State of Florida as Datalink Systems, Inc. in 1983. In 1998, we reincorporated in Nevada, and in November of 2002, we changed our name to our current name, Applied DNA Sciences, Inc. In November 2005, our corporate headquarters were relocated from Los Angeles, California to the Long Island High Technology Incubator at Stony Brook University in Stony Brook, New York. This relocation was part of our restructuring effort during the fourth quarter of 2005 to transform the company from the developmental stage to an operating business. During this period and in the first two quarters of 2006, we established laboratories for the manufacture of DNA markers and product prototypes, and DNA authentication. To date, the company has a very limited operating history, and as a result, the company's operations have produced insignificant revenues. On May 9, 2006, we entered into, and on July 25, 2006 we announced the performance of our first SigNature Program contract.

#### Overview

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We provide botanical DNA encryption, embedment and authentication solutions that can help protect companies, governments and consumers from counterfeiting, fraud, piracy, product diversion, identity theft, and unauthorized intrusion into physical locations and databases. Our SigNature Program provides a secure, accurate and cost-effective means for our potential customers to incorporate our SigNature DNA Markers in, and then quickly and reliably authenticate and identify, a broad range of items such as artwork and collectibles, fine wine, consumer products, digital media, financial instruments, identity cards and other official documents. Having the ability to reliably authenticate and identify counterfeit versions of such items enables companies and governments to detect, deter, interdict and prosecute counterfeiting enterprises and individuals.

Our SigNature Program enables our potential clients to cost-effectively:

- o give assurance to manufacturers, suppliers, distributors, retailers and end-users that their products are authentic and can be forensically authenticated;
- o integrate our SigNature DNA Markers with existing security solutions such as barcodes, radio frequency identification (RFID) tags, holograms, microchips and other securities measures; and
- o add value to the "bottom-line" by helping to diminish product diversion and counterfeiting.

3

Counterfeit and diverted products continue to pose a significant and growing problem with consumer packaged goods, especially for prestige and established brands worldwide. Piracy, identity theft and forged documents and items are also highly prevalent in vertical markets such as digital media, fine art, luxury goods, and alcoholic beverages. Key aspects of our strategy include:

- o continuing to improve and customize our solution to meet our potential customers' needs;
- o continuing to develop and enhance our existing DNA marker authentication technologies;
- o expanding our customer base both domestically and abroad by targeting high volume markets; and
- o augmenting our competitive position through strategic acquisitions and alliances.

### Industry Background

Counterfeiting, product diversion, piracy, forgery, identity theft, and unauthorized intrusion into physical locations and databases create significant and growing problems to companies in a wide range of industries as well as governments and individuals worldwide. The U.S. Chamber of Commerce reported in 2006 that counterfeiting and piracy cost the U.S. economy between \$200-\$250 billion per year, or an estimated 750,000 American jobs, and pose a real threat to consumer health and safety. The World Customs Organization and Interpol estimate that annual global trade in illegitimate goods increased from \$5.5 billion in 1982 to roughly \$600 billion in 2004.

Product counterfeiting and diversion particularly harms manufacturers of consumer products, especially for prestige and established brands, and the consumers who purchase them. For instance, according to the Gieschen

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Consultancy's 2005 Document, Product and Intellectual Property Security Report, or DOPIP, consumer products associated with worldwide counterfeit enforcement arrests, charges, convictions, sentences and civil litigation in 2005 amounted to around \$1.5 billion. This total includes:

- o \$695 million of entertainment and software products;
- o \$283 million of clothing and accessories;
- o \$193 million of cigarettes and tobacco products;
- o \$61 million of drugs and other medical supplies;
- o \$36 million of toys and sports equipment;
- o \$35 million of electronic equipment and supplies;
- o \$12 million in perfume and cosmetics;
- o \$11 million of food and alcohol products;
- o \$11 million in jewelry and watches;
- o \$10 million of computer equipment and supplies;
- o \$123 million of other goods.

According to this report, the value of seizures and losses associated with counterfeit documents, products and intellectual property in the United States alone was \$1.29 billion in 2005.

The artworks and collectibles markets are also particularly vulnerable to counterfeiting, forgery and fraud. New works are produced and then passed off as originating from a particular artistic period or source, authentic fragments are pieced together to simulate an original work, and existing works are modified in order to increase their purported value. Such phony artwork and collectibles are then often sold with fake or questionable signatures and "provenance," or documented ownership histories that confirm authenticity.

Governments are increasingly vulnerable to counterfeiting, terrorism and other security threats at least in part because currencies, identity and security cards and other official documents can be counterfeited with relative ease. For instance, the DOPIP valued 2005 seizures and losses associated with counterfeit currency at around \$609 billion, and counterfeit identification at \$124 million. Governments must also enforce the various anti-counterfeiting and anti-piracy regimes of their respective jurisdictions which becomes increasingly difficult with the continued expansion of global trade.

The digital and recording media industry, including the segment that records computer software on compact discs, has long been a victim of piracy, or the production of illegal copies of genuine media or software, and the counterfeiting and distribution of imitation media or software. Compact discs, DVDs, videotapes, computer software and other digital and recording media that appears identical to genuine products are sold at substantial discounts by vendors at street and night markets, via mail order catalogs and on the internet at direct retail websites or at auction sites. In 2006 the Business Software Alliance ("BSA") reported that in 2005, the United States lost \$6.9 billion as a result of software piracy. The BSA also estimated that 21 percent of software programs in the U.S. are unlicensed and that since January 1, 2000, the BSA has settled with 1,668 companies for a total of \$81,821,895. In a white paper published in December 2005, the BSA and the IDC also reported that they found in a 2004 study

that the world spent more than \$59 billion for commercial packaged software. Yet, software worth over \$90 billion was actually installed. In other words, for every two dollars worth of software purchased legitimately, one

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dollar was obtained illegally.

The pharmaceutical industry also faces major problems relative to counterfeit, diluted, or falsely labeled drugs that make their way through healthcare systems worldwide, posing a health threat to patients and a financial threat to drugmakers and distributors. In 2006 the Center for Medicine in the Public Interest predicted that counterfeit drug sales will reach \$75 billion globally in 2010, an increase of more than 90% from 2005. In February, 2006, the World Health Organization ("WHO") estimated that counterfeits account for more than 10% of the global pharmaceuticals market, 25% of pharmaceuticals consumed in developing countries and as much as 50% in some countries, are counterfeit. According to the WHO, counterfeiting can apply to both branded and generic products and counterfeit pharmaceuticals may include products with the correct ingredients but fake packaging, with the wrong ingredients, without active ingredients or with insufficient active ingredients. The challenges presented by traditional counterfeiters have recently been supplemented by the many websites, from direct retailers to auction sites, that offer counterfeit prescription drugs online. As a result, the pharmaceutical industry and regulators are examining emerging anti-counterfeit technologies, including radio-frequency identification tags and electronic product codes, known as EPCs, to help stem the wave of counterfeit drugs and better track legitimate drugs from manufacturing through the supply chain.

As more and more companies in each of these markets begin to address the problem of counterfeiting, we expect that different systems will compete to be the leading standards by which products can be tracked across world markets. Historically, counterfeiting, product diversion and other types of fraud have been combated by embedding various authentication systems and rare and easily distinguishable materials into products, such as radio frequency identification (RFID) devices and banknote threads in packaging, integrated circuit chips and magnetic strips in automatic teller machine cards, holograms on currency, elemental taggants in explosives, and radioactivity and rare molecules in crude oil. These techniques are effective but have generally been reverse-engineered and replicated by counterfeiters, which limits their usefulness as forensic methods for authentication of the sources of products and other items.

### The Applied DNA Solution

We believe our solution, which we call the SigNature Program, is as broadly applicable, convenient and inexpensive as existing authentication systems, while highly resistant to reverse-engineering or replication, so that it can either be applied independently or supplement existing systems in order to allow for a forensic level of authentication of the sources of a broad range of items, such as artwork and collectibles, fine wine, consumer products, digital and recording media, pharmaceuticals, financial instruments, identity cards and official documents. The SigNature Program first involves our design and manufacture of a highly customized and encrypted botanical DNA marker, or SigNature DNA Marker. The SigNature DNA Marker is then encapsulated and stabilized so that it is resistant to heat, organic solvents, chemicals and most importantly, ultraviolet, or UV radiation. Once it has been encapsulated, our SigNature DNA Embedment system can be used to embed the SigNature DNA Marker directly onto products or other items or into special inks, threads and other media, which in turn can be incorporated into packaging or products. Once it is embedded, our SigNature DNA Encryption Detector pen can instantly show the presence or absence of any of our SigNature DNA Markers, and our SigNature polymerase chain reaction (PCR) Kits can provide rapid forensic level authentication of specific SigNature DNA Markers.

We believe that the key characteristics and benefits of the SigNature Program are as follows:

We Believe Our SigNature DNA Markers Are Virtually Impossible to Copy

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In creating unique SigNature DNA Markers, we use DNA segments from one or more botanical sources, rearrange them into unique encrypted sequences, and then implement one or more layers of anti-counterfeit techniques. Because the portion of DNA in a SigNature DNA Marker used to identify the marker is so minute, it cannot be detected unless it is replicated billions of times over, or amplified. This amplification can only be achieved by applying matching strands of DNA, or a primer, and PCR techniques to the SigNature DNA Marker. The sequence of the relevant DNA in a SigNature DNA Marker must be known in order to manufacture the primer for that DNA. As a result, we believe the effort required to find, amplify, select and clone the relevant DNA in a SigNature DNA Marker would involve such enormous effort and expense that SigNature DNA Markers are virtually impossible to copy without our proprietary systems.

### Simple and Rapid Authentication

With our advanced SigNature DNA Marker detection devices and PCR testing kits, any of our customers can quickly complete an on-site verification. When our SigNature DNA Encryption Detector pen comes in contact

5

with our proprietary overt ink on a label or product package, a biochemical reaction triggers a reversible color change from blue to pink and back to blue. Testing of this color change can be repeated between 30 to 50 times. For forensic level authentication, our SigNature PCR testing kits can produce absolute authentication in less than 30 minutes using portable PCR machines.

### Low Cost and High Accuracy

The costs associated with the DNA required to manufacture our SigNature DNA Markers are not significant since the amount of DNA required for each marker is so minute (for instance, only 3-5 parts per million when incorporated in an ink). We manufacture the identifying segment of DNA to be used in a SigNature DNA Marker by cloning them inside microorganisms such as yeast or bacteria, which are highly productive and inexpensive to grow. As a result, SigNature DNA Markers are relatively inexpensive when compared to other anti-counterfeiting devices such as RFIDs, EPCs, integrated circuit chips, and holograms. Our SigNature DNA Encryption Detectors, which use color changing dyes and molecular "triggers" to instantly detect SigNature DNA Markers, are also relatively inexpensive. At the same time, the probability of mistakenly identifying a SigNature DNA Marker is less than 1 in 1 trillion, so our authentication systems are highly accurate, and in fact, our SigNature PCR Kits can authenticate to a forensic level.

### Easily Integrated with Other Anti-Counterfeit Technologies

Our DNA Markers can be embedded onto RFID devices, banknote threads, labels, serial numbers, holograms, and other marking systems using inks, threads and other media. We believe that combined with other traditional methods, our SigNature Program provides a significant deterrent against counterfeiting, product diversion, piracy, fraud and identity theft.

### Broad Applicability and Ingestible

Our SigNature DNA Markers can be embedded into almost any consumer product, and virtually any other item. For instance, the indelible SigNature DNA Ink we produce is safe to consume and can be used in pharmaceutical drug tablets

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and capsules. Use of our SigNature DNA in ingestible products and drugs will require FDA approval. We have initiated a strategy to approach FDA in the first quarter of calendar year 2007.

### Our Strategy

We expect to generate revenues principally from sales of our SigNature Program. Key aspects of our strategy include:

#### Customize and Refine the SigNature Program to Meet Potential Customers' Needs

We are continuously attempting to improve our SigNature Program by testing the incorporation of our DNA Markers into different media, such as newly configured labels, inks or packing elements, for use in new applications. Each prospective customer has specific needs and employs varying levels of existing security technologies with which our solution must be integrated. Our goal is to develop a secure and cost-effective system for each potential customer that can be incorporated into that potential customer's products or items themselves or their packaging so that they can, for instance, be tracked throughout the entire supply chain and distribution system.

#### Continue to Enhance Detection Technologies for Authentication of our SigNature DNA Markers

We have also identified and are further examining opportunities to collaborate with companies and universities to develop a new line of detection technologies that will provide faster and more convenient ways to authenticate our SigNature DNA Markers.

#### Target Potential High-Volume Markets

We will continue to focus our efforts on target vertical markets that are characterized by a high level of vulnerability to counterfeiting, product diversion, piracy, fraud, identity theft, and unauthorized intrusion into physical locations and databases. Today our target markets include art and collectibles, fine wine, consumer products, digital and recording media, pharmaceuticals, and homeland security. If and when we have significantly penetrated these markets, we intend to expand into additional related high volume markets.

#### Pursue Strategic Acquisitions and Alliances

We intend to pursue strategic acquisitions of companies and technologies that strengthen and complement our core technologies, improve our competitive positioning, allow us to penetrate new markets, and grow our customer base. We also intend to work in collaboration with our licensee Biowell and potential strategic partners in order to continue to market and sell new product lines derived from, but not limited to, DNA technology.

### Target Markets

A licensee of our products, Biowell, has incorporated DNA markers, based upon the same technology we use to create our SigNature DNA Markers, in more than 1 billion consumer products including DVDs, CDs, fine art, cosmetics, luxury teas and rice wine, seafood and many other items distributed in Asia. We have just begun offering our products and services in Europe and the United



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States and are targeting the following six principal markets:

### Art & Collectibles

The fine art and collectibles markets are particularly vulnerable to counterfeiting, forgeries and fraud. Phony artwork and collectibles are often sold with fake or questionable signatures or attributions. We believe our SigNature DNA Markers can safely be embedded directly in, and so can be used to designate and then authenticate all forms of artwork and collectibles, including paintings, books, porcelain, marble, stone, bronzes, tapestries, glass and fine woodwork, including frames. They can also be embedded in any original supporting documentation related to the artwork or collectible, the signature of the artist and any other relevant material that would provide provenance, such as:

- o A signed certificate or statement of authenticity from a respected authority or expert on the artist;
- o An exhibition or gallery sticker attached to the art or collectible;
- o An original sales receipt;
- o A film or recording of the artist talking about the art or collectible;
- o An appraisal from a recognized authority or expert on the art or collectible; and
- o Letters or papers from recognized experts or authorities discussing the art or collectible.

### Fine Wine

Vintners and purveyors of fine wine are also vulnerable to counterfeiting or product diversion. We believe our SigNature Program can provide vintners and purveyors of fine wines several benefits:

- o Verified authenticity increases potential customers' confidence in the product and their purchase decision;
- o For the vintner, the SigNature Program can strengthen brand support and recognition, and offers the potential for improved marketability and sales; and,
- o SigNature DNA Markers can be embedded in bottles, labels, or both at the winery, and easily authenticated at the location of the wine distributor or auctioneer.

### Consumer Products

Counterfeit items are a significant and growing problem with all kinds of consumer packaged goods, especially in the retail and apparel industries. According to the 2005 DOPIP, up to \$283 million worth of clothing and accessories worldwide are fake, as well as \$12 million worth of fragrances and cosmetics are counterfeit each year. In the United States, \$1.29 billion dollars worth of seizures and losses were incurred resulting from counterfeit of apparel and other consumer products. We have developed and are currently marketing a number of solutions aimed at brand protection and authentication for the retail and apparel industries, including the clothing, accessories, fragrances and cosmetics segments. Our SigNature Program can be used by manufacturers in these industries to combat counterfeiting and piracy of primary, secondary and tertiary packaging, as well as the product itself, and to track products that have been lost in transit, whether misplaced or stolen.

### Digital and Recording Media

The digital and recording media industry, including the segment that records computer software on compact discs, faces significant threats from piracy and the counterfeiting and distribution of imitation media or software.

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For instance, according to the BSA, in 2005 the United States lost \$6.9 billion as a result of software piracy. Our SigNature DNA Markers can be embedded onto digital and recording media products, such as CDs, DVDs, videotapes and computer software, as well as the packaging of these products.

### Pharmaceuticals

The pharmaceutical industry also faces major problems relative to counterfeit, diluted, or falsely labeled drugs that make their way through healthcare systems worldwide, posing a health threat to patients and a financial threat to drugmakers and distributors. As a result, the pharmaceutical industry and regulators are examining emerging anti-counterfeit technologies, including RFID tags and EPCs to help stem the wave of counterfeit drugs and better track legitimate drugs from manufacturing through the supply chain. Our SigNature DNA Markers can easily be embedded directly into pharmaceutical packaging or into RFID tags or EPCs attached to packaging, and

7

since they are ingestible, may be applied as part of a unit dose. In its 2004 report "Combating Counterfeit Drugs," the Food and Drug Administration ("FDA") noted that authentication technologies for pharmaceuticals (such as color-shifting inks, holograms, taggants, or chemical markers embedded in a drug or its label) have been sufficiently perfected that they can now serve as a critical component of a layered approach to control counterfeit drugs. FDA's 2004 Report acknowledged the importance of using one or more authentication technologies for drug products.

### Homeland Security

Governments worldwide are increasingly faced with the problems of counterfeit currencies, official documents, and identity and security cards, as well as terrorism and other security threats. Governments must also enforce the various anti-counterfeiting and anti-piracy regimes of their respective jurisdictions which becomes increasingly difficult with the continued expansion of global trade. Our SigNature Program can provide secure, forensic, and cost-effective anti-counterfeiting, anti-piracy and identification solutions to local, state, and federal governments as well as the defense contractors and the other companies that do business with them. Our SigNature Program can be used for all types of identification and official documents, such as:

- o Passports;
- o Lawful permanent resident, or "green" cards;
- o Visas;
- o Drivers' licenses;
- o Social Security cards;
- o Military identification cards;
- o National transportation cards;
- o Security cards for access to sensitive physical locations; and,
- o Other important identity cards, official documents and security-related cards.

### Our Technology

Every living organism has a unique DNA code that determines the character and composition of its cells. The core technologies of our business allow us to use the DNA of everyday plants to mark objects in a unique manner

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that we believe can only be replicated at great expense, and then identify these objects by detecting the absence or presence of the DNA.

### SigNature DNA Encryption

Our patent pending encryption system allows us to isolate strands of botanical DNA and then fragment and reconstitute them to form unique "DNA chimers", or encrypted DNA segments, whose sequences are known only to us.

### SigNature DNA Encapsulation

Our patented encapsulation system allows us to apply a protective coating to encrypted DNA chimers, creating a SigNature DNA Marker that is resistant to heat, organic solvents, chemicals and UV radiation, and so can be identified for hundreds of years after being embedded directly, or into media applied or attached to the item to be marked.

### SigNature DNA Embedment

Our patented embedment system allows us to incorporate our SigNature DNA Markers into a broad variety of media, such as petroleum and petroleum derivatives, inks, dyes, laminates, glues, threads, and textiles.

### SigNature DNA Authentication

Our patent pending forensic level authentication methods allow us to unlock the encrypted DNA chimers by using PCR techniques and proprietary primers that were specifically designed by us to detect the DNA sequences we encrypted and embedded into the product or other item. Detection of the DNA chimers unique to a particular item or series of items allows us to authenticate its or their origin.

### Products And Services

Our SigNature Program consists of three steps: creating and encapsulating a specific encrypted DNA segment, applying it to a product or other item, and detecting the presence or absence of the specific segment. We plan for the first two steps to be controlled exclusively by Applied DNA and its certified agents to ensure the security of SigNature DNA Markers. Once applied, the presence of any of our SigNature DNA Markers can be detected by us or a customer in a simple spot test, or a sample taken from the product or other item can be analyzed

8

forensically to obtain definitive proof of the presence or absence of a specific type of SigNature DNA Marker (e.g. one designed to mark a particular product).

### Creating a Customer or Product-Specific SigNature DNA Marker

Our SigNature DNA Markers are botanical DNA segments custom manufactured by us to identify a particular class of or individual products or items. During this manufacturing process, we scramble and encrypt a naturally occurring botanical DNA code segment or segments, and then encapsulate the resulting DNA segment utilizing our proprietary SigNature DNA Encapsulation system. We then record and store the sequence of the DNA segment in a secure database in order that we can later detect it.

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### Embedding the SigNature DNA Marker

Our SigNature DNA Markers may be directly embedded in products or other items, or otherwise attached by embedding them into media that is incorporated in or attached to the product or item. For example, we can embed SigNature DNA Markers directly in paper, metal, plastics, stone, ceramic, and other materials. Media in which we can embed SigNature DNA Markers include:

**SigNature DNA Ink:** Our SigNature DNA Ink can be applied directly or on a label that is then affixed to the product or item. SigNature DNA Ink is highly durable and degradation resistant. SigNature DNA Ink can be visible (colored) or invisible. This makes it possible to mark products with a visible, or overt, and/or invisible, or covert, SigNature DNA Marker on any tangible surface such as a label. The location of covert Signature DNA Markers on a product are recorded and stored in a secure database. Similar media like varnish and paints can also be used instead of ink. Examples of products and other items onto which SigNature DNA Ink can be applied include:

- o Artwork and Collectibles: paintings, artifacts, antiques, stamps, coins, documents, collectibles and memorabilia;
- o Corporate documents: confidential, date and time dependent documents or security clearance documents;
- o Financial services: currency, stock certificates, checks, bonds and debentures;
- o Retail: event tickets, VIP tickets, clothing labels, luxury products;
- o Pharmaceuticals: tablet, capsule and pill surface printing; and,
- o Miscellaneous: lottery tickets, inspection stamps, custom seals, passports and visas, etc.

**SigNature DNA Thread:** Our SigNature DNA Thread, which can consist of any fabric from cotton to wool, is embedded with SigNature DNA Markers and can be used to mark and authenticate products and other items incorporating textiles. For example, SigNature DNA Thread can be incorporated in a finished garment, bag, purse, shoe or other product or item. SigNature DNA Thread can help textile vendors, clothing and accessory manufacturers and governments authenticate thread, yarn and fabric at any stage in the supply chain.

**Other Security Devices:** Our SigNature DNA Markers can also be embedded onto printed barcodes, RFID tags, optical memory strips, holograms, tamper proof labels and other security devices incorporated into products and other items for various security-related purposes.

### SigNature DNA Detection and Product Authentication

**Level 1 "Spot Test" Detection:** Our SigNature DNA Encryption Detector pens, which are custom manufactured to identify our SigNature DNA Markers, allow us or our customers to determine the presence or absence of these markers in around one second when they have been embedded in a special overt DNA Ink. When the SigNature DNA Encryption Detector is swiped over matching overt DNA Ink, the color of the ink temporarily changes from blue to pink, indicating the presence of the markers, and validating the product or other item. Though this detection process cannot distinguish between different types of SigNature DNA Markers, such as markers we have designed for one customer or product versus another, it allows for instant sampling at any point in the supply chain.

**Level 2 Forensic DNA Authentication:** Our SigNature PCR Kits allow us or our customers to use a sample taken from the product or other item to be authenticated, and using our proprietary primers and PCR technology, determine the sequences of DNA included in the sample, and conclude whether it includes a specific SigNature DNA Marker. This more elaborate test generally requires about

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30 minutes to complete. This authentication process provides absolute certainty about the presence or absence of specific types of a SigNature DNA Marker.

9

### Sales and Marketing

We have since inception only had sales of our products in Europe through direct sales. As of January 16, 2007, we had 2 employees devoted to and 3 employees engaged in direct sales. We expect to hire additional sales directors and/or consultants to assist us with sales and marketing efforts with respect to our 6 target vertical markets.

### Research and Development

From June 1, 2005 to September 20, 2005, we retained the Idaho National Laboratory ("INL"), which is managed and operated by Battelle Energy Alliance LLC for the Department of Energy, for the purpose of independently validating our SigNature DNA Encryption, Encapsulation, Embedment and Authentication technologies. Currently our research and development efforts are primarily focused on the development of prototypes of new versions of our products using our existing technologies for review by prospective customers, such as different types of SigNature DNA Ink and SigNature DNA Thread. Nonetheless, we believe that our development of new and enhanced technologies relating to our business may be important to our future success, and we continue to examine whether investments in the research and development of such technologies is merited.

### Manufacturing

We have the capability to manufacture SigNature DNA Markers, covert DNA Ink, and SigNature PCR Kits at our laboratories in Stony Brook. We rely upon Biowell to manufacture our overt color-changing DNA Ink and our SigNature DNA Encryption Detector pens.

### Competition

The principal markets for our SigNature Program are intensely competitive. We compete with many existing suppliers and new competitors continue to enter the market. Many of our competitors, both in the United States and elsewhere, are major pharmaceutical, chemical and biotechnology companies, or have strategic alliances with such companies, and many of them have substantially greater capital resources, marketing experience, research and development staff, and facilities than we do. Any of these companies could succeed in developing products that are more effective than the products that we have or may develop and may be more successful than us in producing and marketing their existing products. Some of our competitors that operate in the anti-counterfeiting and fraud prevention markets include: Applied Optical Technologies, Authentix, ChemTAG, Collectors Universe Inc., Collotype, Data Dot Technology, Digimarc Corp., DNA Technologies, Inc., Informium AG, Inksure Technologies, L-1 Identity Solutions, Manakoa, SmartWater Technology, Inc., SureTrace, Tracetag and Warnex.

Some examples of competing security products include:

- o Fingerprint scanner: a system that scans fingerprints before granting access to secure information or facilities;
- o Voice recognition software: software that authenticates users

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- based on individual vocal patterns;
- o Cornea scanner: a scanner that scan the iris of a user's eye to compare with data in a computer database;
- o Face scanner: a scanning system that use complex algorithms to distinguish one face from another;
- o Integrated circuit chip & magnetic strips: integrated circuit chips that receive and, if authentic, send a correct electric signal back to the reader, and magnetic strips that contain information, both of which are common components of debit and credit cards;
- o Optically variable microstructures: these include holograms, which display images in three dimensions and are generally difficult to reproduce using advanced color photocopiers and printing techniques, along with other devices with similar features;
- o Elemental Taggants and Fluorescence: elemental taggants are various unique substances that can be used to mark products and other items, are revealed by techniques such as x-ray fluorescence; and,
- o Radioactivity & Rare Molecules: radioactive substances or rare molecules which are uncommon and readily detected.

We expect competition with our products and services to continue and intensify in the future. We believe competition in our principal markets is primarily driven by:

- o product performance, features and liability;
- o price;
- o timing of product introductions;

10

- o ability to develop, maintain and protect proprietary products and technologies;
- o sales and distribution capabilities;
- o technical support and service;
- o brand loyalty;
- o applications support; and
- o breadth of product line.

If a competitor develops superior technology or cost-effective alternatives to our products, our business, financial condition and results of operations could be significantly harmed.

### PROPRIETARY RIGHTS

We believe that our 7 patents, 14 patents pending, 2 registered trademarks, and 2 registered trademarks pending, which are described in the table below, and our trademarks, trade secrets, copyrights and other intellectual property rights are important assets for us.

#### Patents Issued:

Patent Name

Patent No:

Assignee of Record

Date

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Nucleic Acid as Marker for Product Anticounterfeiting and Identification	89108443	APDN (B.V.I.) Inc.	Mar
Method of using ribonucleic acid as product antifake mark and for verification	00107580.2	Rixflex Holdings Limited (2)	Feb
EppenLocker (A Leakage-Prevention Apparatus of Microcentrifuge)	89204158	APDN (B.V.I.) Inc.	Mar
Multiple Tube Structure for Multiple PCR in a Closed Container	89210575	APDN (B.V.I.) Inc.	Jun
A Device for Multiple Polymerase Chain Reactions In a Closed Container and a Method of Using Thereof	89111477	APDN (B.V.I.) Inc.	Jun
Method for Mixing Nucleic Acid in Water Insoluble Media and Application Thereof	921221973	APDN (B.V.I.) Inc.	Aug
A Method of Utilizing Nucleic Acids as Markers for Product Anti-Counterfeit Labeling and Verification	US 7,115,301 B2	Rixflex Holdings Limited (2)	Oct

Patents Pending:

Patent Name	Application No.	Filed in the Name of	Dat
Method for Mixing Nucleic Acid in Water Insoluble Media and Application Thereof	2002-294229	Biowell (1)	Aug
	03007023.9	Rixflex Holdings Limited (2)	Mar
	10/645,602	Rixflex Holdings Limited (2)	Aug
Method of dissolving nucleic acid in water insoluble medium and its application	03155949.2	Rixflex Holdings Limited (2)	Aug
Novel nucleic acid based steganography system and application thereof	10/909,431	Rixflex Holdings Limited (2)	Aug
Patent Name			

11

thereof

Cryptic method of secret information carried in DNA molecule and it deencryption method	921221490	APDN (B.V.I.) Inc.	Aug
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A novel nucleic acid based steganography system and application thereof	03127517.6	Biowell (1)	Aug
	61387/2004	Rixflex Holdings Limited (2)	Aug
A novel method for coding based on nucleic acids and utility thereof	04018374.1	Rixflex Holdings Limited (2)	Aug
	1-2004-00742	Rixflex Holdings Limited (2)	Aug
A novel nucleic acid based steganography system and applications thereof	092819	Rixflex Holdings Limited (2)	Aug
	PI20043145	Biowell (1)	Aug
	2004-225987	Rixflex Holdings Limited (2)	Aug
	P-00200400374	Rixflex Holdings Limited (2)	Aug
	764/CHE/2004	Rixflex Holdings Limited (2)	Aug
Method for classifying group ID of shoppers and transferring the shopping discount to group development funds development	92119302	APDN (B.V.I.) Inc.	Jul
Method For transferring feedback foundation capable of identifying multiple objects	03150071.4	Rixflex Holdings Limited (2)	Jul
Method of Classifying Group ID of Shoppers and Transferring the Shopping Discount to Group Development Funds	PI20042889	Rixflex Holdings Limited (2)	Aug
	092217	Rixflex Holdings Limited (2)	Jul
	2004-200730	Biowell (1)	Jul
System and Method for authenticating multiple components associated with a particular product.	11/437,265	APDN (B.V.I.) Inc.	May
	PCT/US2006/019660	APDN (B.V.I.) Inc.	May



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System and Method for Marking Textiles with Nucleic Acid	10/825,968	APDN (B.V.I.) Inc.	Apr
Method for Transferring Feedback-Foundation capable of identifying multiple objects	92119302 03150071.4	APDN (B.V.I.) Inc. Rixflex Holdings Limited(2)	Jul Jul

(1) All patents in the name of and patent applications filed in the name of Biowell have been assigned to our wholly-owned subsidiary APDN (B.V.I.) Inc., and we are making efforts to ensure APDN (B.V.I.) is the assignee or filer of record, as the case may be.

(2) All patents in the name of and patent applications filed in the name of Rixflex Holdings Limited, which merged into APDN (B.V.I.) Inc. on July 12, 2005, have been assigned to APDN (B.V.I.) Inc., and we are making efforts to ensure APDN (B.V.I.) is the assignee or filer of record, as the case may be.

### Trademarks Issued:

Trademark	Registration No:	Registered Owner	Re
APPLIED DNA and model molecule design	846354	Applied DNA Sciences Inc.	Au
APPLIED DNA and model molecule design	846711	Applied DNA Sciences Inc.	Au
APPLIED DNA and model molecule design	3392818	Applied DNA Sciences Inc.	Ma
BIOWELL and Design	3,155,578	Rixflex Holdings Limited (1)	Oc
BIOWELL and Design	2,675,941	Rixflex Holdings Limited (1)	Ja
BIOWELL and Design	2,611,291	Rixflex Holdings Limited (1)	Au
BIOWELL and Design	4101159010000	Biowell (2)	Ma
BIOWELL and Design	4,819,252	Rixflex Holdings Limited (1)	No

(1) All registered trademarks in the name of Rixflex Holdings Limited have been assigned to APDN (B.V.I.) Inc., and we are making efforts to ensure APDN (B.V.I.) Inc. is the registered owner.

(2) All registered trademarks in the name of Biowell have been assigned to APDN (B.V.I.) Inc., and we are making efforts to ensure APDN

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(B.V.I.) Inc. is the registered owner.

Trademarks Pending:

Trademark	Application No:	Owner
APPLIED DNA	76/549,861	APDN (B.V.I.) Inc.
SIGNATURE	78/871,967	APDN (B.V.I.) Inc.

However, there are events that are outside of our control that pose a threat to our intellectual property rights as well as to our products and services. For example, effective intellectual property protection may not be available

13

in every country in which our products and services are distributed. The efforts we have taken to protect our proprietary rights may not be sufficient or effective. Any significant impairment of our intellectual property rights could harm our business or our ability to compete. Protecting our intellectual property rights is costly and time consuming. Any increase in the unauthorized use of our intellectual property could make it more expensive to do business and harm our operating results. Although we seek to obtain patent protection for our innovations, it is possible we may not be able to protect some of these innovations. Given the costs of obtaining patent protection, we may choose not to protect certain innovations that later turn out to be important. There is always the possibility that the scope of the protection gained from one of our issued patents will be insufficient or deemed invalid or unenforceable. We also seek to maintain certain intellectual property as trade secrets. This secrecy could be compromised by third parties, or intentionally or accidentally by our employees, which would cause us to lose the competitive advantage resulting from these trade secrets.

Additionally, litigation regarding patents and other intellectual property rights is extensive in the biotechnology industry. In the event of an intellectual property dispute, we may be forced to litigate. This litigation could involve proceedings instituted by the U.S. Patent and Trademark Office or the International Trade Commission, as well as proceedings brought directly by affected third parties. Intellectual property litigation can be extremely expensive, and these expenses, as well as the consequences should we not prevail, could seriously harm our business. If a third party claims an intellectual property right to technology we use, we might need to discontinue an important product or product line, alter our products and processes, pay license fees or cease our affected business activities. Although we might under these circumstances attempt to obtain a license to this intellectual property, we may not be able to do so on favorable terms, or at all.

### Strategic Alliances

#### Purchase of Intellectual Property and License Agreement with Biowell

In the first half of 2005, Biowell transferred substantially all of its

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intellectual property to Rixflex Holdings Limited, a British Virgin Islands company, and on July 12, 2005, Rixflex Holdings Limited merged with and into our wholly-owned subsidiary APDN (B.V.I.) Inc., a British Virgin Islands company. The shareholders of Rixflex Holdings Limited received 36 million shares of our common stock in consideration of this merger. In connection with the acquisition of this Biowell intellectual property, we terminated the license agreement that we had previously entered into with Biowell in October 2002, under which we had the exclusive right to sell, market, and sub-license certain Biowell intellectual property within the United States, the European Union, Canada, Mexico, Colombia, Saudi Arabia and the United Arab Emirates. Also in connection with this acquisition, on July 12, 2005, the Company entered into a license agreement with Biowell, whereby the Company granted Biowell an exclusive license to sell, market, and sub-license certain of the Company's products in most Asian countries and certain Middle Eastern countries. The license is for an initial term ending December 31, 2010, and if Biowell meets its performance goals, the license agreement will extend for an additional five year term. If Biowell sub-licenses these products within these countries, Biowell is required to pay the Company 50% of all fees, payments or consideration or any kind received in connection with the grant of the sublicense. Biowell is also required to pay a royalty of 10% on all net sales of these products and is required to meet certain minimum annual net sales in each of the various countries covered by the license. We have the right to terminate the exclusivity of the license with respect to any particular country if Biowell fails to meet its annual net sales requirements for that country during the first year after the date of the agreement, and to terminate the license altogether with respect to any particular country if Biowell fails to meet its annual net sales requirements for that country for two consecutive years. Although Biowell has not met its annual net sales requirements for any particular country to date, we have not yet terminated the exclusivity of the license with respect to any country. Cumulative royalties earned from this agreement for the period from July 2005 through September 30, 2006 totaled \$33,722. Until the license agreement is terminated, it also provides us ownership of all improvements, modifications or alterations made by Biowell to the licensed products, the technologies underlying them, or the mode of using them, that are related to our business, and provides Biowell an exclusive license to any such improvements, modifications or alterations made by us.

### Sub-License Agreement with G.A. Corporate Finance

In July of 2003, we, Biowell and G. A. Corporate Finance Ltd. entered into a Sub-License Agreement for the United Kingdom in exchange for \$3 million. G. A. Corporate Finance Ltd. paid \$25,000 upon its execution of the Agreement, and the remaining \$2.975 million in the form of its interest bearing promissory note, payable in twenty (20) consecutive quarterly installments of principal and interest in the amount equal to the lesser of \$185,937.50 or 35% of gross revenues for that quarter it generated from sales of certain of our products in the United Kingdom, due on the final day of each quarter. Due in part to our lack of marketable products during the first two years after the date of this agreement, G.A. Corporate Finance Ltd. has not generated any revenue from

sales of our products in the United Kingdom, and so has never made any payments to us under its note. We are currently in negotiations with G.A. Corporate Finance Ltd. to either amend or terminate this agreement.

### Employees

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Presently, we employ a total of 7 full-time employees and 2 part-time employees, including 2 in management, 3 in operations, 3 in sales and marketing and 1 in investor relations. None of our employees are covered by collective bargaining agreements, and we believe our relations with our employees are favorable.

### ITEM 2. DESCRIPTION OF PROPERTY.

We maintain our principal office at 25 Health Sciences Drive, Suite 113, Stony Brook, New York 11790. We moved our principal office to the Long Island High Technology Incubator, which is located on the campus of Stony Brook University, in December 2005. We believe that our current office space and facilities are sufficient to meet our present needs and do not anticipate any difficulty securing alternative or additional space, as needed, on terms acceptable to us.

### ITEM 3. LEGAL PROCEEDINGS.

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. Except as described below, we are currently not aware of any such legal proceedings that we believe will have, individually or in the aggregate, a material adverse affect on our business, financial condition or operating results.

Paul Reep v. Applied DNA Sciences, Inc., Case No.: BC345702

Plaintiff Paul Reep, a former employee, commenced this action against us on January 10, 2006. Mr. Reep asserts eight causes of action for breach of contract, breach of an oral agreement, negligent misrepresentation, interference with prospective business advantages, defamation, fraud, accounting and constructive trust, unjust enrichment. The relief sought includes declaratory relief, unspecified compensatory damages, unpaid salary, unspecified penalties under the California Labor Code, interest, and attorneys' fees. We have successfully moved the court to indefinitely stay all proceedings in this matter in light of a forum selection clause designating Nevada state courts as the proper forum. Attorneys for Reep have indicated that they intend to file suit in Nevada, but to date have not done so. We intend to vigorously defend any case brought against us by Reep.

Applied DNA Sciences, Inc. v. Paul Reep, Adrian Butash, John Barnett, Chanty Cheang, Jaime Cardona, and Angela Wiggins, Case No. CV06-2027 RGK

We filed this action against the defendants, Paul Reep, Adrian Butash, John Barnett, Chanty Cheang, Jaime Cardona, and Angela Wiggins on April 4, 2006, in the United States District Court for the Central District of California. In this matter we have asked the court to make a judicial determination that an agreement amending the employment contracts of all named defendants, which we did not authorize and which is the basis of the Reep and Butash litigation against Applied DNA, is invalid and unenforceable. This matter is in the early stages of discovery. Trial has been set for April 3, 2007.

Barnett, et al. v. Applied DNA Sciences, et al., Case No.: BC 350904

Plaintiffs John D. Barnett, Jr., Adrian Butash, Jaime A. Cardona, and Chanty Cheang, our former employees, filed suit against us, Applied DNA Operations Management, Inc., APDN (B.V.I.), Inc., Peter Brocklesby, James A. Hayward, and Jun-Jei Sheu in Los Angeles County Superior Court on April 17, 2006. The complaint alleges causes of action for breach of written contract, breach of oral contract, fraud, violations of the California Labor Code, and wrongful termination. The complaint seeks \$159,000 (trebled to \$477,000) in

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alleged unpaid salary, \$546,000 in severance pay, other unspecified compensatory and consequential damages, unspecified punitive damages, attorneys' fees and costs, and interest. With the exception of Peter Brocklesby, all defendants, including us, have answered the complaint. The trial date has been set for May 21, 2007.

In re the Unemployment Insurance Claims of Adrian Butash, John Barnett, and Paul Reep, California Unemployment Insurance Appeals Board Case Nos. 1809031, 1801356, and 1842399, respectively.

We are in the process of appealing an administrative law judge's determination John Barnett, Paul Reep, and Adrian Butash are entitled to unemployment benefits following their separation from employment with us and that our unemployment insurance account will be charged. We will appeal on the determination on the grounds that the claimants were terminated for reasons other than lack of work. We have filed a notice of appeal, and no trial date has yet been set.

15

Douglas A. Falkner v. Applied DNA Sciences, Inc./N.C. Industrial Commission File No. 585698

Plaintiff Douglas Falkner ("Falkner") filed a worker's compensation claim in North Carolina for an alleged work-related neck injury that he alleges occurred on January 14, 2004. Falkner worked as Business Development and Operations Manager at our sole East Coast office at the time of the alleged injury. Plaintiff Falkner was the only employee employed by us in North Carolina at the time of the alleged injury and we have employed no other employees in North Carolina at any other time. The claim has been denied and is being defended on several grounds, including the lack of both personal and subject matter jurisdiction. Specifically, we contend that we did not employ the requisite minimum number of employees in North Carolina at the time of the alleged injury and that the company is therefore not subject to the North Carolina Workers' Compensation Act. The claim was originally set for hearing in January 2007, but was continued to allow the parties to engage in further discovery.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

### PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

#### Market Information

Our Common Stock is traded over-the-counter on The Over The Counter Bulletin Board (the "OTC Bulletin Board") maintained by the National Association of Securities Dealers under the symbol "APDN." There is no certainty that the Common Stock will continue to be quoted or that any liquidity exists for our shareholders.

The following table sets forth the quarterly quotes of high and low prices for our Common Stock on the OTC Bulletin Board during the fiscal years ended September 30, 2005 and September 30, 2006. In February of 2003, we changed our year end to September 30. We changed our fiscal year end in connection with

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a reverse merger we entered into in December 2002, in which the acquirer for accounting purposes had a fiscal year end of September 30. For ease of fiscal reporting, we adopted the same fiscal year end.

	Fiscal 2006 =====		Fiscal 2005 =====	
	High =====	Low =====	High =====	Low =====
First Quarter	\$0.58	\$0.16	\$2.39	\$0.42
Second Quarter	\$0.37	\$0.15	\$1.83	\$0.78
Third Quarter	\$0.27	\$0.10	\$1.01	\$0.58
Fourth Quarter	\$0.17	\$0.07	\$0.74	\$0.48

### Holder

As of December 29, 2006, we had approximately 1,309 holders of our common stock. The number of record holders was determined from the records of our transfer agent and does not include beneficial owners of common stock whose shares are held in the names of various security brokers, dealers, and registered clearing agencies. The transfer agent of our common stock is American Stock Transfer & Trust Company, 6201 15th Avenue, Brooklyn, New York 11219.

### Dividends

We have never declared or paid any cash dividends on our common stock. We do not anticipate paying any cash dividends to stockholders in the foreseeable future. In addition, any future determination to pay cash dividends will be at the discretion of the Board of Directors and will be dependent upon our financial condition, results of operations, capital requirements, and such other factors as the Board of Directors deem relevant.

### Recent Sales of Unregistered Securities

In October 2005, We issued 400,000 shares of common stock for services rendered. We valued the shares issued at \$0.50 per share for a total of \$200,000, which represents the fair value of the services received which did not differ materially from value of the services received. This issuance is considered exempt under Regulation D of the Securities Act of 1933 and Rule 506 promulgated thereunder.

On July 10, 2006, we issued 2,400,000 shares of common stock in exchange for services rendered. We valued the shares issued at \$0.20 per share for a total of \$480,000, which did not differ materially from the value of the stock issued and represented the fair value of the services received. This issuance is considered exempt under Regulation D of the Securities Act of 1933 and Rule 506 promulgated thereunder.

On December 12, 2006 we issued 180,000 shares of common stock in exchange for our promissory note in principal amount of \$410,429 and accrued interest thereon of \$8,883. We valued the shares issued at \$0.09 per share for a

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total of \$16,200. This issuance is considered exempt under Section 3(a)(9) of the Securities Act of 1933.

### ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

The following discussion should be read in conjunction with our Consolidated Financial Statements and Notes thereto, included elsewhere within this report. The Annual Report on Form 10-KSB contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, including statements using terminology such as "can", "may", "believe", "designated to", "will", "expect", "plan", "anticipate", "estimate", "potential" or "continue", or the negative thereof or other comparable terminology regarding beliefs, plans, expectations or intentions regarding the future. You should read statements that contain these words carefully because they:

- o discuss our future expectations;
- o contain projections of our future results of operations or of our financial condition; and
- o state other "forward-looking" information.

We believe it is important to communicate our expectations. However, forward looking statements involve risks and uncertainties and our actual results and the timing of certain events could differ materially from those discussed in forward-looking statements as a result of certain factors, including those set forth under "Risk Factors," "Business" and elsewhere in this prospectus. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to us as of the date thereof, and we assume no obligations to update any forward-looking statement or risk factor, unless we are required to do so by law.

#### Introduction

We provide botanical DNA encryption, embedment and authentication solutions that can help protect companies, governments and consumers from counterfeiting, fraud, piracy, product diversion, identity theft, and unauthorized intrusion into physical locations and databases. Our SigNature Program provides a secure, accurate and cost-effective means for customers to incorporate our SigNature DNA Markers in, and then quickly and reliably authenticate and identify, a broad range of items such as artwork and collectibles, fine wine, consumer products, digital media, financial instruments, identity cards and other official documents. Having the ability to reliably authenticate and identify counterfeit versions of such items enables companies and governments to detect, deter, interdict and prosecute counterfeiting enterprises and individuals.

Our SigNature Program enables our potential clients to cost-effectively:

- o assure manufacturers, suppliers, distributors, retailers and end-users that their products are authentic and can be forensically authenticated;
- o integrate our SigNature DNA Markers with existing security solutions such as barcodes, radio frequency identification (RFID) tags, holograms, microchips and other securities measures; and
- o add value to the "bottom-line" by helping to diminish product diversion and counterfeiting.

Counterfeit and diverted products continue to pose a significant and growing problem with consumer packaged goods, especially for prestige and established brands worldwide. Piracy, identity theft and forged documents and

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items are also highly prevalent in vertical markets such as digital media, fine art, luxury goods, and alcoholic beverages. Key aspects of our strategy include:

- o continuing to improve and customize our solution to meet our potential customers' needs;
- o continuing to develop and enhance our existing DNA marker authentication technologies;
- o expanding our customer base both domestically and abroad by targeting high volume markets; and
- o augmenting our competitive position through strategic acquisitions and alliances.

### Plan of Operations

#### General

We expect to generate revenues principally from sales of our SigNature Program. We are currently attempting to develop business in six target markets: art and collectibles, fine wine, consumer products, digital recording media, pharmaceuticals, and homeland security driven programs. We intend to pursue both domestic and international sales opportunities in each of these vertical markets.

We believe that our existing capital resources will enable us to fund our operations until approximately April 2007. We believe we may be required to seek additional capital to sustain or expand our prototype and sample

17

manufacturing, and sales and marketing activities, and to otherwise continue our business operations beyond that date. We have no commitments for any future funding, and may not be able to obtain additional financing or grants on terms acceptable to us, if at all, in the future. If we are unable to obtain additional capital this would restrict our ability to grow and may require us to curtail or discontinue our business operations. Additionally, while a reduction in our business operations may prolong our ability to operate, that reduction would harm our ability to implement our business strategy. If we can obtain any equity financing, it may involve substantial dilution to our then existing shareholders.

#### Product Research and Development

We anticipate spending approximately \$200,000 for product research and development activities during the next twelve (12) months.

#### Acquisition of Plant and Equipment and Other Assets

We do not anticipate the sale of any material property, plant or equipment during the next 12 months. We do anticipate spending approximately \$100,000 on the acquisition of leasehold improvements during the next 12 months. We believe our current leased space is adequate to manage our growth, if any, over the next 2 to 3 years.

#### Number of Employees

From our inception through the period ended September 30, 2006, we have principally relied on the services of outside consultants for services. We currently have seven employees and two part-time employees. Specifically, the



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company expects to increase its staffing dedicated to sales, product prototyping, manufacturing of DNA markers and forensic authentication services. Expenses related to travel, marketing, salaries, and general overhead will be increased as necessary to support our growth in revenue. In order for us to attract and retain quality personnel, we anticipate we will have to offer competitive salaries to future employees. We anticipate that it may become desirable to add additional full and or part time employees to discharge certain critical functions during the next 12 months. This projected increase in personnel is dependent upon our ability to generate revenues and obtain sources of financing. There is no guarantee that we will be successful in raising the funds required or generating revenues sufficient to fund the projected increase in the number of employees. As we continue to expand, we will incur additional costs for personnel.

### Critical Accounting Policies

Financial Reporting Release No. 60, published by the SEC, recommends that all companies include a discussion of critical accounting policies used in the preparation of their financial statements. While all these significant accounting policies impact our financial condition and results of operations, we view certain of these policies as critical. Policies determined to be critical are those policies that have the most significant impact on our consolidated financial statements and require management to use a greater degree of judgment and estimates. Actual results may differ from those estimates.

We believe that given current facts and circumstances, it is unlikely that applying any other reasonable judgments or estimate methodologies would cause a material effect on our consolidated results of operations, financial position or liquidity for the periods presented in this report.

The accounting policies identified as critical are as follows:

- o Equity issued with registration rights
- o Warrant liability
- o Fair value of intangible assets

### Equity Issued with Registration Rights

In connection with placement of our convertible notes and warrants to certain investors during the fiscal quarters ended December 31, 2003, December 31, 2004, March 31, 2005, March 31, 2006 and June 30, 2006, we granted certain registration rights that provide for liquidated damages in the event of failure to timely perform under the agreements. Although these notes and warrants do not provide for net-cash settlement, the existence of liquidated damages provides for a defacto net-cash settlement option. Therefore, the common stock underlying the notes and warrants subject to such liquidated damages does not meet the tests required for shareholders' equity classification, and accordingly has been reflected between liabilities and equity in the accompanying consolidated balance sheet until such time as the conditions are eliminated.

### Warrant Liability

In connection with the placement of certain debt instruments, as described above, we issued freestanding warrants. Although the terms of the warrants do not provide for net-cash settlement, in certain circumstances, physical or net-share settlement is deemed to not be within our control and,

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accordingly, we are required to account for these freestanding warrants as a derivative financial instrument liability, rather than as shareholders' equity.

The warrant liability is initially measured and recorded at its fair value, and is then re-valued at each reporting date, with changes in the fair value reported as non-cash charges or credits to earnings. For warrant-based derivative financial instruments, the Black-Scholes option pricing model is used to value the warrant liability.

The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is re-assessed at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

We do not use derivative instruments to hedge exposures to cash flow, market, or foreign currency risks.

### Fair Value of Intangible Assets

We have adopted SFAS No. 142, Goodwill and Other Intangible Assets, whereby we periodically test our intangible assets for impairment. On an annual basis, and when there is reason to suspect that their values have been diminished or impaired, these assets are tested for impairment, and write-downs will be included in results from operations. On July 12, 2005, we acquired certain intellectual properties from Biowell through an Asset Purchase Agreement in exchange for 36 million shares of our restricted common stock having an aggregate fair value at the date of issuance of \$24.12 million. The value of the acquired intangible assets was \$9,430,900, with the balance of the purchase price, or \$14,689,100, charged to operations as a cost of the transaction.

During the year ended September 30, 2006, the Company management preformed an evaluation of its intangible assets (intellectual property) for purposes of determining the implied fair value of the assets at September 30, 2006. The test indicated that the recorded remaining book value of its intellectual property exceeded its fair value, as determined by discounted cash flows. As a result, upon completion of the assessment, management recorded a non-cash impairment charge of \$5,655,011, net of tax, or \$0.05 per share during the year ended September 30, 2006 to reduce the carrying value of the patents to \$2,091,800. Considerable management judgment is necessary to estimate the fair value. Accordingly, actual results could vary significantly from management's estimates.

The identifiable intangible assets acquired and their carrying value at September 30, 2006 are:

	Gross	Accumulated		Weighted
	Carrying	Amortization	Residual	Average
	Amount	and	Value	Amortization
		Impairment		Period
		Charge	Net	(Years)
	=====	=====	=====	=====
Amortizable				
Intangible				
Assets:				

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Intellectual Property	\$9,430,900	\$7,339,100	\$2,091,800	--	7
Patents	34,237	18,574	15,663	--	5
Total Amortized Identifiable Intangible	\$9,465,137 =====	\$7,357,674 =====	\$2,107,463 =====	-- --	6.99

19

Total amortization expense charged to operations for the year ended September 30, 2006 and 2005 were \$1,354,101 and \$346,825.

Estimated amortization expense as of September 30, 2006 are as follows:

2007	\$ 370,643
2008	370,643
2009	365,753
2010	363,792
2011 and after	636,632
Total	\$ 2,107,463

### Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenue and expenses during the reporting period. The most significant estimates relate to the estimation of percentage of completion on uncompleted contracts, valuation of inventory, allowance for doubtful accounts and estimated life of customer lists. Actual results could differ from those estimates.

### Restatement of Consolidated Financial Statements

The Company has restated its consolidated financial statements as of September 30, 2005 and for the year ended September 30, 2005 and the quarterly unaudited data for the first three quarters of 2006 and all of 2005.

These restatements and resulting revisions relate to the accounting treatment for and disclosing the issuance by the Company of options and warrants to acquire the Company's common stock. In addition the Company corrected certain errors in accounting for the exchange of its common stock for previously incurred debt with a Company director. These errors were discovered in connection with comments raised by the SEC in their review and comment on this Registration Statement.

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In this regard, you should rely on the restated financial results for the year and each of the quarters in the years 2005 and the first, second and third quarters of 2006 and, as the Company previously reported in its Current Report on Form 8-K, dated May 16, 2006, you should not rely on the Company's previously issued consolidated financial statements and other financial information for these reporting periods.

As a result, the accompanying consolidated financial statements for the year ended September 30, 2005 and the quarterly periods ended December 31, 2005, March 31, 2006 and June 30, 2006 have been restated from the amounts previously reported to correct the accounting for financial derivatives. While the effect of the corrections to the financial statements is fully described in accompanying notes to the restated consolidated financial statements, the following is a summary of the net effect of the errors on these consolidated financial statements:

- o the Company's net loss for the year ended September 30, 2005 increased by \$14,499,139 from \$52,610,380 to \$67,109,519;
- o the Company's current liabilities as of September 30, 2005 increased by \$384,651 from \$2,595,897 to \$2,980,548; and,
- o the Company's other liabilities, representing warranty liabilities, as of September 30, 2005 increased by \$13,673,574 from \$0 to \$13,673,574.

### Revenues

From our inception on September 16, 2002, we did not generate material revenues from operations. We have, however, generated \$0.019 million in sales of our products for the year ended September 30, 2006. Our cost of sales for the same period was \$0.016 million netting us a gross profit of \$0.003 million. All of our revenues from sales of our products in the year ended September 30, 2006 are attributable to Dr. Suwelack Skin & Health Care AG ("Dr. Suwelack"). James A. Hayward, a director and our Chief Executive Officer, serves on Dr. Suwelack's board of directors. BioCogent, whose President and Chief Executive Officer and sole stockholder is Dr. Hayward, provides consulting services to Dr. Suwelack.

### Costs and Expenses

#### Selling, General and Administrative

20

Selling, general and administrative expenses for the twelve months ended September 30, 2006 compared to 2005 decreased 496% to \$8.5 million from \$50.7 million in the prior period. See a discussion of non cash items below in the Liquidity & Capital Resources section. Included within the selling, general and administrative expenses for the year ended September 30, 2005 were expensed intellectual property of \$14.7 million and costs relating to fund raising and consultant costs of \$4.7 million. Additionally, for the year ended September 30, 2006, we had a reduction in fair value of warrants issued to non employees of \$5.8 million as compared to the year ended September 30, 2005 and a reduction in common stock issued in exchange for services rendered of \$16.8 million as compared to the same period last year.

#### Research and Development

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Research and development expenses decreased \$485,682 for the twelve months ended September 30, 2006 compared to 2005 from \$0.6 million to \$0.2 primarily due to decreased independent testing costs.

### Depreciation and Amortization

In the twelve months ended September 30, 2006, depreciation and amortization increased \$1,014,033 for the period compared to 2005 from \$356,266 to \$1,370,299. The increase is attributable to entire year amortization of our intellectual property acquired in 2005.

### Impairment of intangible asset(s)

During the year ended September 30, 2006, we performed an evaluation of our intangible assets (intellectual property) and determined that the implied fair carrying value exceeded its fair value. Accordingly, we recorded a non cash impairment charge to operations of \$5.7 million in the year ended September 30, 2006 as compared to \$0 in the prior year.

### Total Operating Expenses

Total operating expenses decreased to \$15.7 million from \$51.7 million, or a decrease of \$36 million as a result of the combination of factors listed above.

### Other Income/Loss

Net loss for the twelve months ended September 30, 2006 decreased to a loss of \$2.4 million from a loss of \$67.1 million in the prior period as a result of the combination of factors described above.

### Interest Expenses

Interest expense, for the twelve months ended September 30, 2006 decreased to \$3.6 million from \$32.1 million in the same period of 2005, an decrease of \$28.5 million. For the year ended September 30, 2005, we incurred a non cash interest expense relating to the fair value of warrants issued in conjunction with our financing of \$23.1 million.

### Net Income (loss)

Net loss for the twelve months ended September 30, 2006 decreased to a loss of \$2.4 million from a loss of \$6.7 million in the prior period as a result of the combination of factors described above.

### Liquidity and Capital Resources

Our liquidity needs consist of our working capital requirements, indebtedness payments and research and development expenditure funding. Historically, we have financed our operations through the sale of equity and convertible debt as well as borrowings from various credit sources.

As of September 30, 2006, we had a working capital deficit of \$4.6 million. For the year ended September 30, 2006, we generated a net cash flow deficit from operating activities of \$2.8 million consisting primarily of year to date losses of \$2.4 million. Non cash adjustments included \$2.0 million in depreciation and amortization charges, \$5.7 million in impairment charges, \$3.0 million for options, warrants and common stock issued in exchange for services, \$2.3 million in financing costs attributable to issuance of warrants and net change in net increase in current liabilities of \$2.5 million net with a non cash adjustment of \$16.8 million for income attributable to re-pricing of warrants and debt derivatives. Cash used in investing activities totaled \$0.2

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million, which was utilized for acquisition of property and equipment. Cash provided by financing activities for the year ended September 30, 2006 totaled \$4.2 million consisting of proceeds from issuance of convertible debt.

We expect capital expenditures to be less than \$500,000 in fiscal 2007. Our primary investments will be in laboratory equipment to support prototyping and our authentication services.

21

Exploitation of potential revenue sources will be financed primarily through the sale of securities and convertible debt, exercise of outstanding warrants, issuance of notes payable and other debt or a combination thereof, depending upon the transaction size, market conditions and other factors.

While we have raised capital to meet our working capital and financing needs in the past, additional financing is required within the next 3 months in order to meet our current and projected cash flow deficits from operations and development. We have sufficient funds to conduct our operations for several months, but not for 3 months or more. There can be no assurance that financing will be available in amounts or on terms acceptable to us, if at all.

By adjusting our operations and development to the level of capitalization, we believe we have sufficient capital resources to meet projected cash flow deficits. However, if during that period or thereafter, we are not successful in generating sufficient liquidity from operations or in raising sufficient capital resources, on terms acceptable to us, this could have a material adverse effect on our business, results of operations liquidity and financial condition.

Our registered independent certified public accountants have stated in their report dated January 5, 2007, that we have incurred operating losses in the last two years, and that we are dependent upon management's ability to develop profitable operations. These factors among others may raise substantial doubt about our ability to continue as a going concern.

In fiscal 2005, we completed two private placements of convertible debt and associated warrants. In November and December, 2004 we issued and sold \$1.465 million in aggregate principal amount of promissory notes, convertible at \$0.50 per share, and associated warrants to purchase up to 2,930,000 shares of our common stock, exercisable at \$0.75 per share for three years from their date of issuance, to 13 investors (the "December 2004 Placement"). Each promissory note was automatically convertible into shares of our common stock at a price of \$0.50 per share upon the closing of a subsequent private placement by us for at least \$1 million. In January and February of 2005, we issued and sold \$7.371 million in aggregate principal amount of 10% Secured Convertible Promissory Notes, convertible at \$0.50 per share, and associated warrants to purchase up to 14,742,000 shares of our common stock, exercisable at \$0.75 per share until five years from their date of issuance, to 61 investors (the "January and February 2005 Placement"). Upon the closing of the January and February 2005 Offering, the notes issued in the December 2004 Placement automatically converted into an aggregate of 2,930,000 shares of our common stock, and upon the filing of this registration statement on February 15, 2005, the notes issued in the January and February 2005 Placement automatically converted into an aggregate of 14,742,000 shares of our common stock. Additional private placements in fiscal 2005 raised \$243,000. We also received proceeds of \$60,000 from the exercise of a warrant to purchase 100,000 shares of our common stock in fiscal 2005. The \$9.135 million in gross proceeds from these private placements and warrant exercises were used

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to fund commissions, fees and expenses associated with the placements, consultants and public reporting costs, salaries and wages, royalties, research and development, facility costs as well as general working capital needs. Since the conversion price of the notes issued in the November and December 2003, December 2004, December 2005 and the January and February 2005 placements were less than the market price of our common stock at the time these notes were issued, we recognized a charge relating to the beneficial conversion feature of these notes during the quarter in which they are issued.

In fiscal 2006, we completed three additional private placements of convertible debt and associated warrants. On November 3, 2005, we issued and sold a promissory note in the principal amount of \$550,000 to Allied International Fund, Inc. ("Allied"). Allied in turn financed a portion of the making of this loan by borrowing \$450,000 from certain persons, including \$100,000 from James A. Hayward, a director and our Chief Executive Officer. The terms of the promissory note provided that we issue upon the funding of the note warrants to purchase 5,000,000 shares of our common stock at an exercise price of \$0.50 per share to certain persons designated by Allied. On November 9, 2005, we issued nine warrants to Allied and eight other persons to purchase an aggregate of 5,500,000 shares of our common stock at an exercise price of \$0.50 per share. These warrants included a warrant to purchase 1,100,000 shares that was issued to James A. Hayward, a director and our Chief Executive Officer. We paid \$55,000 in cash to VC Arjent, Ltd. for its services as the placement agent with respect to this placement. All principal and accrued but unpaid interest under the promissory note was paid in full shortly after the closing of and from the proceeds of a private placement we completed on March 8, 2006. On March 8, 2006, we issued and sold an aggregate of 30 units consisting of (i) a \$50,000 principal amount secured convertible promissory note bearing interest at 10% per annum and convertible at \$0.50 per share, and (ii) a warrant to purchase 100,000 shares of our common stock at an exercise price of \$0.50 per share, for aggregate gross proceeds of \$1.5 million. The units were sold pursuant to subscription agreements by and between each of the purchasers and Applied DNA Operations Management, Inc., a Nevada corporation and our wholly owned subsidiary (our "Subsidiary"). The \$2.050 million

22

in gross proceeds from these first two offerings were held by our Subsidiary for our benefit and used to fund commissions, fees and expenses associated with the placements, to repay the outstanding promissory note described above plus accrued interest thereunder, to fund financing fees, consultants and public reporting costs, salaries and wages, research and development, facility costs as well as and general working capital needs. On March 24, 2006, we commenced an offering (the "Offshore Offering") of up to 140 units, at a price of \$50,000 per unit, for a maximum offering of \$7 million for sale to "accredited investors" who are not "U.S. persons." The units being sold as part of the Offshore Offering consist of (i) a \$50,000 principal amount secured convertible promissory note, and (ii) a warrant to purchase 100,000 shares of our common stock at a price of \$0.50 per share. On May 2, 2006, we closed on the first tranche of the Offshore Offering in which we sold 20 units for aggregate gross proceeds of \$1,000,000. We paid Arjent Limited \$375,000 in commissions, fees and expenses from these gross proceeds. On June 15, 2006, we completed the second tranche of the Offshore Offering in which we sold 59 units for aggregate gross proceeds of \$2,950,000. We paid Arjent Limited \$442,500 in commissions, fees and expenses from these gross proceeds. Additionally, on July 10, 2006 we issued 2.4 million shares of our common stock to Arjent Limited at \$0.001 per share as partial consideration for its services in connection with the Offshore Offering.

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On March 29, 2006 and April 13, 2006, we borrowed \$200,000 in the aggregate, at a rate of 7.5% per annum, from BioCogent whose President and Chief Executive Officer and sole stockholder is James A. Hayward, one of our directors and our Chief Executive Officer. These loans were due and payable upon the earlier to occur of (1) the close of business on June 30, 2006, or (2) the closing of the issuance and sale of our securities for gross proceeds of at least \$250,000. The proceeds from the loans were used for general corporate purposes. The note issued on March 29, 2006 was repaid with interest in May, 2006. The note issued on April 13, 2006 was repaid with interest in June, 2006.

We presently do not have any available credit, bank financing or other external sources of liquidity. Due to our brief history and historical operating losses, our operations have not been a source of liquidity. We will need to obtain additional capital in order to expand operations and become profitable. We intend to pursue the building of a re-seller network outside the United States, and if successful, the re-seller agreements would constitute a source of liquidity and capital over time. In order to obtain capital, we may need to sell additional shares of our common stock or borrow funds from private lenders. There can be no assurance that we will be successful in obtaining additional funding and execution of re-seller agreements outside the United States.

We will still need additional investments in order to continue operations to cash flow break even. Additional investments are being sought, but we cannot guarantee that we will be able to obtain such investments. Financing transactions may include the issuance of equity or debt securities, obtaining credit facilities, or other financing mechanisms. However, the trading price of our common stock and the downturn in the U.S. stock and debt markets could make it more difficult to obtain financing through the issuance of equity or debt securities. Even if we are able to raise the funds required, it is possible that we could incur unexpected costs and expenses, fail to collect significant amounts owed to us, or experience unexpected cash requirements that would force us to seek alternative financing. Further, if we issue additional equity or debt securities, stockholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of existing holders of our common stock. If additional financing is not available or is not available on acceptable terms, we will have to curtail our operations.

Substantially all of the real property used in our business is leased under operating lease agreements.

### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

### Going Concern

The financial statements included in this filing have been prepared in conformity with generally accepted accounting principles that contemplate our continuance as a going concern. Our auditors, in their report dated January 5, 2007, have expressed substantial doubt about our ability to continue as going concern. Our cash position may be inadequate to pay all of the costs associated with the testing, production and marketing of our products. Management intends to use borrowings and the sale of equity or convertible debt to mitigate the effects of its cash position, however no assurance can be given that debt or equity financing, if and when required will be available. The financial statements do not include any adjustments relating to the recoverability and classification of recorded assets and classification of liabilities that might be necessary should we be unable to continue existence.



FACTORS THAT COULD AFFECT FUTURE RESULTS

Because of the following factors, as well as other variables affecting our operating results and financial condition, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

Risks Relating to Our Business:

We have a Short Operating History, a Relatively New Business Model, and Have Not Produced Significant Revenues. This Makes it Difficult to Evaluate Our Future Prospects and Increases the Risk That We Will Not Be Successful.

We have a short operating history with our current business model, which involves the marketing, sale and distribution of botanical DNA encryption, embedment and authentication products and services, which are based on technologies that we acquired in July 12, 2005 from, and some of which are manufactured for us by, Biowell Technology, Inc. ("Biowell"). We first derived revenue from this model in the second calendar quarter of 2006, which was insignificant. Prior to the July 12, 2005 acquisition, our operations consisted principally of providing marketing and business development services to Biowell. As a result, we have a very limited operating history for you to evaluate in assessing our future prospects. We are in the process of transitioning from a developmental stage to an early-stage growth enterprise. Our operations since inception have not produced significant revenues, and may not produce significant revenues in the near term, or at all, which may harm our ability to obtain additional financing and may require us to reduce or discontinue our operations. If we create revenues in the future, prior to our introduction of any new products, we will derive all such revenues from the sale of botanical DNA encryption, encapsulation, embedment and authentication products and services, which is an immature industry. You must consider our business and prospects in light of the risks and difficulties we will encounter as an early-stage company in a new and rapidly evolving industry. We may not be able to successfully address these risks and difficulties, which could significantly harm our business, operating results, and financial condition.

We Have a History Of Losses Which May Continue, and Which May Harm Our Ability to Obtain Financing and Continue Our Operations.

We incurred net losses of \$2.4 million for the year ended September 30, 2006 and \$6.7 million for the year ended September 30, 2005. These net losses have principally been the result of the various costs associated with our selling, general and administrative expenses as we commenced operations, acquired, developed and validated technologies, began marketing activities, and our interest expense on notes and warrants we issued to obtain financing. Our operations are subject to the risks and competition inherent in a company moving from the development stage to a new growth enterprise. We may not generate sufficient revenues from operations to achieve or sustain profitability on a quarterly, annual or any other basis in the future. Our revenues and profits, if any, will depend upon various factors, including whether our existing products and services or any new products and services we develop will achieve any level of market acceptance. If we continue to incur losses, our accumulated deficit will continue to increase, which might significantly impair our ability to obtain additional financing. As a result, our business, results of operations and financial condition would be significantly harmed, and we may be required to reduce or terminate our operations.

If We Are Unable to Obtain Additional Financing Our Business Operations Will be

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Harmed or Discontinued, and If We Do Obtain Additional Financing Our Shareholders May Suffer Substantial Dilution.

We believe that our existing capital resources will enable us to fund our operations until approximately April, 2007. We believe we will be required to seek additional capital to sustain or expand our prototype and sample manufacturing, and sales and marketing activities, and to otherwise continue our business operations beyond that date. We have no commitments for any future funding, and may not be able to obtain additional financing or grants on terms acceptable to us, if at all, in the future. If we are unable to obtain additional capital this would restrict our ability to grow and may require us to curtail or discontinue our business operations. Additionally, while a reduction in our business operations may prolong our ability to operate, that reduction would harm our ability to implement our business strategy. If we can obtain any equity financing, it may involve substantial dilution to our then existing shareholders.

Our Independent Auditors Have Expressed Substantial Doubt About Our Ability to Continue As a Going Concern, Which May Hinder Our Ability to Obtain Future Financing.

In their report dated January 5, 2007, our independent auditors stated that our financial statements for the year ended September 30, 2006 were prepared assuming that we would continue as a going concern, and that they have substantial doubt about our ability to continue as a going concern. Our auditors' doubts are based on our

24

incurring net losses of \$92.3 million during the period from September 16, 2002 (date of inception) to September 30, 2006. We continue to experience net operating losses. Our ability to continue as a going concern is subject to our ability to generate a profit and/or obtain necessary funding from outside sources, including by the sale of our securities, obtaining loans from financial institutions, or obtaining grants from various organizations or governments, where possible. Our continued net operating losses and our auditors doubts increase the difficulty of our meeting such goals and our efforts to continue as a going concern may not prove successful.

If Our Existing Products and Services are Not Accepted by Potential Customers or We Fail to Introduce New Products and Services, Our Business, Results of Operations and Financial Condition Will be Harmed.

There has been limited or no market acceptance of our botanical DNA encryption, encapsulation, embedment and authentication products and services to date. Some of the factors that will affect whether we achieve market acceptance of our solutions include:

- o availability, quality and price relative to competitive solutions;
- o customers' opinions of the solutions' utility;
- o ease of use;
- o consistency with prior practices;
- o scientists' opinions of the solutions' usefulness;
- o citation of the solutions in published research; and
- o general trends in anti-counterfeit and security solutions' research.

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The expenses or losses associated with the continued lack of market acceptance of our solutions will harm our business, operating results and financial condition.

Rapid technological changes and frequent new product introductions are typical for the markets we serve. Our future success may depend in part on continuous, timely development and introduction of new products that address evolving market requirements. We believe successful new product introductions may provide a significant competitive advantage because customers invest their time in selecting and learning to use new products, and are often reluctant to switch products. To the extent we fail to introduce new and innovative products, we may lose any market share we then have to our competitors, which will be difficult or impossible to regain. Any inability, for technological or other reasons, to successfully develop and introduce new products could reduce our growth rate or damage our business. We may experience delays in the development and introduction of products. We may not keep pace with the rapid rate of change in anti-counterfeiting and security products' research, and any new products acquired or developed by us may not meet the requirements of the marketplace or achieve market acceptance.

If We Are Unable to Retain the Services of Drs. Hayward or Liang We May Not Be Able to Continue Our Operations.

Our success depends to a significant extent upon the continued service Dr. James A. Hayward, our Chief Executive Officer; and Dr. Benjamin Liang, our Secretary and Strategic Technology Development Officer. We do not have employment agreements with Drs. Hayward or Liang. Loss of the services of Drs. Hayward or Liang could significantly harm our business, results of operations and financial condition. We do not maintain key-man insurance on the lives of Drs. Hayward or Liang.

The Markets for our SigNature Program are Very Competitive, and We May be Unable to Continue to Compete Effectively in this Industry in the Future.

The principal markets for our SigNature Program are intensely competitive. We compete with many existing suppliers and new competitors continue to enter the market. Many of our competitors, both in the United States and elsewhere, are major pharmaceutical, chemical and biotechnology companies, or have strategic alliances with such companies, and many of them have substantially greater capital resources, marketing experience, research and development staff, and facilities than we do. Any of these companies could succeed in developing products that are more effective than the products that we have or may develop and may be more successful than us in producing and marketing their existing products. Some of our competitors that operate in the anti-counterfeiting and fraud prevention markets include: Applied Optical Technologies, Authentix, ChemTAG, Collectors Universe Inc., Collotype, Data Dot Technology, Digimarc Corp., DNA Technologies, Inc., Informium AG, Inksure Technologies, L-1 Identity Solutions, Manakoa, SmartWater Technology, SureTrace, Tracetag and Warnex.

We expect this competition to continue and intensify in the future. Competition in our markets is primarily driven by:

- o product performance, features and liability;

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- o price;
- o timing of product introductions;
- o ability to develop, maintain and protect proprietary products and technologies;
- o sales and distribution capabilities;
- o technical support and service;
- o brand loyalty;
- o applications support; and
- o breadth of product line.

If a competitor develops superior technology or cost-effective alternatives to our products, our business, financial condition and results of operations could be significantly harmed.

We Need to Expand Our Sales, Marketing and Support Organizations and Our Distribution Arrangements to Increase Market Acceptance of Our Products and Services.

We currently have few sales, marketing, customer service and support personnel and will need to increase our staff to generate a greater volume of sales and to support any new customers or the expanding needs of existing customers. The employment market for sales, marketing, customer service and support personnel in our industry is very competitive, and we may not be able to hire the kind and number of sales, marketing, customer service and support personnel we are targeting. Our inability to hire qualified sales, marketing, customer service and support personnel may harm our business, operating results and financial condition. We do not currently have any arrangements with any distributors and we may not be able to enter into arrangements with qualified distributors on acceptable terms or at all. If we are not able to develop greater distribution capacity, we may not be able to generate sufficient revenue to support our operations.

A Manufacturer's Inability or Willingness to Produce Our Goods on Time and to Our Specifications Could Result in Lost Revenue and Net Losses.

Though we manufacture prototypes, samples and some of our own products, we currently do not own or operate any significant manufacturing facilities and depend upon independent third parties, and particularly Biowell, for the manufacture of some of our products to our specifications. The inability of a manufacturer to ship orders of such products in a timely manner or to meet our quality standards could cause us to miss the delivery date requirements of our customers for those items, which could result in cancellation of orders, refusal to accept deliveries or a reduction in purchase prices, any of which could harm our business by resulting in decreased revenues or net losses upon sales of products, if any sales could be made.

If We Need to Replace Manufacturers, Our Expenses Could Increase, Resulting in Smaller Profit Margins.

We compete with other companies for the production capacity of our manufacturers and import quota capacity. Some of these competitors have greater financial and other resources than we have, and thus may have an advantage in the competition for production and import quota capacity. If we experience a significant increase in demand, or if our existing manufacturers must be replaced, we will need to establish new relationships with another or multiple manufacturers. We cannot assure you that this additional third party manufacturing capacity will be available when required on terms that are acceptable to us or terms similar to those we have with our existing manufacturers, either from a production standpoint or a financial standpoint. We do not have long-term contracts with our manufacturers, and our manufacturers do not produce our products exclusively. Should we be forced to replace our manufacturers, we may experience an adverse financial impact, or an adverse

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operational impact, such as being forced to pay increased costs for such replacement manufacturing or delays upon distribution and delivery of our products to our customers, which could cause us to lose customers or lose revenues because of late shipments.

If a Manufacturer Fails to Use Acceptable Labor Practices, We Might Have Delays in Shipments or Face Joint Liability for Violations, Resulting in Decreased Revenue and Increased Expenses.

While we require our independent manufacturers to operate in compliance with applicable laws and regulations, we have no control over their ultimate actions. While our internal and vendor operating guidelines promote ethical business practices and our staff and buying agents periodically visit and monitor the operations of our independent manufacturers, we do not control these manufacturers or their labor practices. The violation of labor or other laws by our independent manufacturers, or by one of our licensing partners, or the divergence of an independent manufacturer's or licensing partner's labor practices from those generally accepted as ethical in the United States, could interrupt, or otherwise disrupt the shipment of finished products to us or damage our reputation. Any of these, in turn, could have a material adverse effect on our financial condition and results of operations, such as the loss of potential revenue and incurring additional expenses.

26

Failure to License New Technologies Could Impair Sales of Our Existing Products or Any New Product Development We Undertake in the Future.

To generate broad product lines, it is advantageous to sometimes license technologies from third parties rather than depend exclusively on the development efforts of our own employees. As a result, we believe our ability to license new technologies from third parties is and will continue to be important to our ability to offer new products. In addition, from time to time we are notified or become aware of patents held by third parties that are related to technologies we are selling or may sell in the future. After a review of these patents, we may decide to seek a license for these technologies from these third parties. There can be no assurance that we will be able to successfully identify new technologies developed by others. Even if we are able to identify new technologies of interest, we may not be able to negotiate a license on favorable terms, or at all. If we lose the rights to patented technology, we may need to discontinue selling certain products or redesign our products, and we may lose a competitive advantage. Potential competitors could license technologies that we fail to license and potentially erode our market share for certain products. Intellectual property licenses would typically subject us to various commercialization, sublicensing, minimum payment, and other obligations. If we fail to comply with these requirements, we could lose important rights under a license. In addition, certain rights granted under the license could be lost for reasons beyond our control, and we may not receive significant indemnification from a licensor against third party claims of intellectual property infringement.

Our Failure To Manage Our Growth In Operations and Acquisitions of New Product Lines and New Businesses Could Harm our Business.

Any growth in our operations, if any, will place a significant strain on our current management resources. To manage such growth, we would need to improve our:

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- o operations and financial systems;
- o procedures and controls; and
- o training and management of our employees.

Our future growth, if any, may be attributable to acquisitions of new product lines and new businesses. Future acquisitions, if successfully consummated, would likely create increased working capital requirements, which would likely precede by several months any material contribution of an acquisition to our net income. Our failure to manage growth or future acquisitions successfully could seriously harm our operating results. Also, acquisition costs could cause our quarterly operating results to vary significantly. Furthermore, our stockholders would be diluted if we financed the acquisitions by incurring convertible debt or issuing securities.

Although we currently only have operations within the United States, if we were to acquire an international operation; we would face additional risks, including:

- o difficulties in staffing, managing and integrating international operations due to language, cultural or other differences;
- o different or conflicting regulatory or legal requirements;
- o foreign currency fluctuations; and
- o diversion of significant time and attention of our management.

Failure to Attract and Retain Qualified Scientific, Production and Managerial Personnel Could Harm Our Business.

Recruiting and retaining qualified scientific and production personnel to perform and manage prototype, sample, and product manufacturing and business development personnel to conduct business development are critical to our success. In addition, our desired growth and expansion into areas and activities requiring additional expertise, such as clinical testing, government approvals, production, and marketing will require the addition of new management personnel and the development of additional expertise by existing management personnel. Because the industry in which we compete is very competitive, we face significant challenges attracting and retaining a qualified personnel base. Although we believe we have been and will be able to attract and retain these personnel, we may not be able to continue to successfully attract qualified personnel. The failure to attract and retain these personnel or, alternatively, to develop this expertise internally would harm our business since our ability to conduct business development and manufacturing will be reduced or eliminated, resulting in lower revenues. We generally do not enter into employment agreements requiring our employees to continue in our employment for any period of time.

27

Our Intellectual Property Rights Are Valuable, and Any Inability to Protect Them Could Reduce the Value of Our Products, Services and Brand.

Our patents, trademarks, trade secrets, copyrights and all of our other intellectual property rights are important assets for us. There are events that are outside of our control that pose a threat to our intellectual property rights as well as to our products and services. For example, effective intellectual property protection may not be available in every country in which our products and services are distributed. The efforts we have taken to protect our proprietary rights may not be sufficient or effective. Any significant

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impairment of our intellectual property rights could harm our business or our ability to compete. Protecting our intellectual property rights is costly and time consuming. Any increase in the unauthorized use of our intellectual property could make it more expensive to do business and harm our operating results. Although we seek to obtain patent protection for our innovations, it is possible we may not be able to protect some of these innovations. Given the costs of obtaining patent protection, we may choose not to protect certain innovations that later turn out to be important. There is always the possibility that the scope of the protection gained from one of our issued patents will be insufficient or deemed invalid or unenforceable. We also seek to maintain certain intellectual property as trade secrets. The secrecy could be compromised by third parties, or intentionally or accidentally by our employees, which would cause us to lose the competitive advantage resulting from these trade secrets.

### Intellectual Property Litigation Could Harm Our Business.

Litigation regarding patents and other intellectual property rights is extensive in the biotechnology industry. In the event of an intellectual property dispute, we may be forced to litigate. This litigation could involve proceedings instituted by the U.S. Patent and Trademark Office or the International Trade Commission, as well as proceedings brought directly by affected third parties. Intellectual property litigation can be extremely expensive, and these expenses, as well as the consequences should we not prevail, could seriously harm our business.

If a third party claims an intellectual property right to technology we use, we might need to discontinue an important product or product line, alter our products and processes, pay license fees or cease our affected business activities. Although we might under these circumstances attempt to obtain a license to this intellectual property, we may not be able to do so on favorable terms, or at all. Furthermore, a third party may claim that we are using inventions covered by the third party's patent rights and may go to court to stop us from engaging in our normal operations and activities, including making or selling our product candidates. These lawsuits are costly and could affect our results of operations and divert the attention of managerial and technical personnel. A court may decide that we are infringing the third party's patents and would order us to stop the activities covered by the patents. In addition, a court may order us to pay the other party damages for having violated the other party's patents. The biotechnology industry has produced a proliferation of patents, and it is not always clear to industry participants, including us, which patents cover various types of products or methods of use. The coverage of patents is subject to interpretation by the courts, and the interpretation is not always uniform. If we are sued for patent infringement, we would need to demonstrate that our products or methods of use either do not infringe the patent claims of the relevant patent and/or that the patent claims are invalid, and we may not be able to do this. Proving invalidity, in particular, is difficult since it requires a showing of clear and convincing evidence to overcome the presumption of validity enjoyed by issued patents.

Because some patent applications in the United States may be maintained in secrecy until the patents are issued, because patent applications in the United States and many foreign jurisdictions are typically not published until eighteen months after filing, and because publications in the scientific literature often lag behind actual discoveries, we cannot be certain that others have not filed patent applications for technology covered by our or our licensor's issued patents or pending applications or that we or our licensors were the first to invent the technology. Our competitors may have filed, and may in the future file, patent applications covering technology similar to ours. Any such patent application may have priority over our or our licensors' patent applications and could further require us to obtain rights to issued patents covering such technologies. If another party has filed a United States patent application on inventions similar to ours, we may have to participate in an

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interference proceeding declared by the United States Patent and Trademark Office to determine priority of invention in the United States. The costs of these proceedings could be substantial, and it is possible that such efforts would be unsuccessful, resulting in a loss of our United States patent position with respect to such inventions.

Some of our competitors may be able to sustain the costs of complex patent litigation more effectively than we can because they have substantially greater resources. In addition, any uncertainties resulting from the initiation and continuation of any litigation could have a material adverse effect on our ability to raise the funds necessary to continue our operations.

28

Accidents Related to Hazardous Materials Could Adversely Affect Our Business.

Some of our operations require the controlled use of hazardous materials. Although we believe our safety procedures comply with the standards prescribed by federal, state, local and foreign regulations, the risk of accidental contamination of property or injury to individuals from these materials cannot be completely eliminated. In the event of an accident, we could be liable for any damages that result, which could seriously damage our business and results of operations.

Potential Product Liability Claims Could Affect Our Earnings and Financial Condition.

We face a potential risk of liability claims based on our products and services, and we have faced such claims in the past. Though we have product liability insurance coverage which we will believe is adequate, we may not be able to maintain this insurance at reasonable cost and on reasonable terms. We also cannot assure that this insurance, if obtained, will be adequate to protect us against a product liability claim, should one arise. In the event that a product liability claim is successfully brought against us, it could result in a significant decrease in our liquidity or assets, which could result in the reduction or termination of our business.

Litigation Generally Could Affect Our Financial Condition and Results of Operations.

We generally may be subject to claims made by and required to respond to litigation brought by customers, former employees, former officers and directors, former distributors and sales representatives, and vendors and service providers. We have faced such claims and litigation in the past and we cannot assure that we will not be subject to claims in the future. In the event that a claim is successfully brought against us, considering our lack of revenue and the losses our business has incurred for the period from our inception to June 30, 2006, this could result in a significant decrease in our liquidity or assets, which could result in the reduction or termination of our business.

We Are Obligated to Pay Liquidated Damages As a Result of Our Failure to Have this Registration Statement Declared Effective Prior to June 15, 2005, and any Payment of Liquidated Damages Will Either Result in Depletion of Our Limited Working Capital or Issuance of Shares of Common Stock Which Would Cause Dilution to Our Existing Shareholders.

Pursuant to the terms of a registration rights agreement with respect to common stock underlying convertible notes and warrants we issued in private



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placements in November and December, 2003, December, 2004, and January and February, 2005, if we did not have a registration statement registering the shares underlying these convertible notes and warrants declared effective on or before June 15, 2005, we are obligated to pay liquidated damages in the amount of 3.5% per month of the face amount of the notes, which equals \$367,885, until the registration statement is declared effective. At our option, these liquidated damages can be paid in cash or restricted shares of our common stock. To date we have decided to pay certain of these liquidated damages in common stock, although any future payments of liquidated damages may, at our option, be made in cash. If we decide to pay such liquidated damages in cash, we would be required to use our limited working capital and potentially raise additional funds. If we decide to pay the liquidated damages in shares of common stock, the number of shares issued would depend on our stock price at the time that payment is due. Based on the closing market prices of \$0.66, \$0.58, \$0.70, \$0.49, \$0.32 and \$0.20 for our common stock on July 15, 2005, August 15, 2005, September 15, 2005, October 17, 2005, November 15, 2005 and December 15, 2005, respectively, we issued a total of 3,807,375 shares of common stock in liquidated damages from August, 2005 to January, 2006 to persons who invested in the January and February, 2005 private placements. The issuance of shares upon any payment by us of further liquidated damages will have the effect of further diluting the proportionate equity interest and voting power of holders of our common stock, including investors in this offering.

We paid liquidated damages in the form of common stock only for the period from June 15, 2005 to December 15, 2005, and only to persons who invested in the January and February, 2005 private placements. We believe that we have no enforceable obligation to pay liquidated damages to holders of any shares we agreed to register under the registration rights agreement for periods after the first anniversary of the date of issuance of such shares, since they were eligible for resale under Rule 144 of the Securities Act during such periods, and such liquidated damages are grossly inconsistent with actual damages to such persons. Nonetheless, as of September 30, we have accrued \$4.0 million in penalties representing further liquidated damages associated with our failure to have the registration statement declared effective by the deadline, and have included this amount in accounts payable and accrued expenses.

Matter Voluntarily Reported to the Securities and Exchange Commission

During the months of March, May, July and August 2005, we issued a total of 8,550,000 shares of our common stock to certain employees and consultants pursuant to the 2005 Incentive Stock Plan. We engaged our

29

outside counsel to conduct an investigation of the circumstances surrounding the issuance of these shares. On April 26, 2006, we voluntarily reported the findings from this investigation to the SEC, and agreed to provide the SEC with further information arising from the investigation. We believe that the issuance of 8,000,000 shares to employees in July 2005 was effectuated by both our former President and our former Chief Financial Officer/Chief Operating Officer without approval of our board of directors. These former officers received a total of 3,000,000 of these shares. In addition, it appears that the 8,000,000 shares issued in July 2005, as well as an additional 550,000 shares issued to employees and consultants in March, May and August 2005, were improperly issued without a restrictive legend stating that the shares could not be resold legally except in compliance with the Securities Act of 1933, as amended. The members of the Company's management who effectuated the stock issuances no longer work for the Company. These shares were not registered under the Securities Act of 1933, or

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the securities laws of any state, and we believe that certain of these shares may have been sold on the open market, though we have been unable to determine the magnitude of such sales. If violations of securities laws occurred in connection with the resale of certain of these shares, the employees and consultants or persons who purchased shares from them may have rights to have their purchase rescinded or other claims against us for violation of securities laws, which could harm our business, results of operations, and financial condition.

### Risks Relating to Our Common Stock

There Are a Large Number of Shares Underlying Our Options and Warrants That May be Available for Future Sale and the Sale of These Shares May Depress the Market Price of Our Common Stock and Will Cause Immediate and Substantial Dilution to Our Existing Stockholders.

As of December 29, 2006, we had 121,162,385 shares of common stock issued and outstanding and outstanding options and warrants to purchase 77,929,464 shares of common stock. All of the shares issuable upon exercise of our options and warrants may be sold without restriction. The sale of these shares may adversely affect the market price of our common stock. The issuance of shares upon exercise of options and warrants will cause immediate and substantial dilution to the interests of other stockholders since the selling stockholders may convert and sell the full amount issuable on exercise.

If We Fail to Remain Current on Our Reporting Requirements, We Could be Removed From the OTC Bulletin Board Which Would Limit the Ability of Broker-Dealers to Sell Our Securities and the Ability of Stockholders to Sell Their Securities in the Secondary Market.

Companies trading on The Over The Counter Bulletin Board (the "OTC Bulletin Board"), such as us, must be reporting issuers under Section 12 of the Securities Exchange Act of 1934, as amended, and must be current in their reports under Section 13, in order to maintain price quotation privileges on the OTC Bulletin Board. If we fail to remain current on our reporting requirements, we could be removed from the OTC Bulletin Board. As a result, the market liquidity for our securities could be severely adversely affected by limiting the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market. Prior to May 2001, we were delinquent in our reporting requirements, having failed to file our quarterly and annual reports for the years ended 1998 - 2000 (except the quarterly reports for the first two quarters of 1999). We have been current in our reporting requirements for the last five years, however, there can be no assurance that in the future we will always be current in our reporting requirements.

Our Common Stock is Subject to the "Penny Stock" Rules of the SEC and the Trading Market in Our Securities is Limited, Which Makes Transactions in Our Stock Cumbersome and May Reduce the Value of an Investment in Our Stock.

The SEC has adopted Rule 15c-9 which establishes the definition of a "penny stock," for the purposes relevant to us, as any equity security that has a market price of less than \$5.00 per share or with an exercise price of less than \$5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules require:

- o that a broker or dealer approve a person's account for transactions in penny stocks; and
- o the broker or dealer receive from the investor a written agreement to the transaction, setting forth the identity and quantity of the penny stock to be purchased.

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In order to approve a person's account for transactions in penny stocks, the broker or dealer must:

- o obtain financial information and investment experience objectives of the person; and
- o make a reasonable determination that the transactions in penny stocks are suitable for that person and the person has sufficient knowledge and experience in financial matters to be capable of evaluating the risks of transactions in penny stocks.

30

The broker or dealer must also deliver, prior to any transaction in a penny stock, a disclosure schedule prescribed by the SEC relating to the penny stock market, which, in highlight form:

- o sets forth the basis on which the broker or dealer made the suitability determination; and
- o that the broker or dealer received a signed, written agreement from the investor prior to the transaction.

Generally, brokers may be less willing to execute transactions in securities subject to the "penny stock" rules. This may make it more difficult for investors to dispose of our common stock and cause a decline in the market value of our stock.

Disclosure also has to be made about the risks of investing in penny stocks in both public offerings and in secondary trading and about the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and the rights and remedies available to an investor in cases of fraud in penny stock transactions. Finally, monthly statements have to be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks.

31

### ITEM 7. FINANCIAL STATEMENTS.

APPLIED DNA SCIENCES, INC.

#### INDEX TO FINANCIAL STATEMENTS

	Page
Report of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheet as of September 30, 2006	F-2
Consolidated Statements of Losses for the years ended September 30, 2006 and 2005 and the period September 16, 2002 (date of inception) to September 30, 2006	F-3
Consolidated Statement of Stockholders' Equity (Deficiency) for the	

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period September 16, 2002 (date of inception) to September 30, 2005	F-4
Consolidated Statements of Cash Flows for the years ended September 30, 2006 and 2005 and the period September 16, 2002 (date of inception) to September 30, 2006	F-19
Notes to Consolidated Financial Statements	F-21

32

### RUSSELL BEDFORD STEFANOU MIRCHANDANI LLP CERTIFIED PUBLIC ACCOUNTANTS

#### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors  
Applied DNA Sciences, Inc.  
Stony Brook, New York

We have audited the accompanying consolidated balance sheet of Applied DNA Sciences, Inc. (a development stage company) as of September 30, 2006 and the related consolidated statements of losses, deficiency in stockholders' equity, and cash flows for each of the two years in the period ended September 30, 2006 and the period September 16, 2002 (date of inception) through September 30, 2006. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on the financial statements based upon our audits.

We have conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Applied DNA Sciences, Inc. (a development stage company) at September 30, 2006 and the results of its operations and its cash flows for the each of the two years in the period ended September 30, 2006 and the period September 16, 2002 (date of inception) through September 30, 2006 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in the Note L to the accompanying financial statements, the Company is in the development stage and has not established a source of revenues. This raises substantial doubt about the company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note M, the Company has restated the consolidated statements of losses, deficiency in stockholders' equity, and cash flows for the year ended September 30, 2005 and the period September 16, 2002 (date of inception) through September 30, 2005.

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/s/ RUSSELL BEDFORD STEFANO MIRCHANDANI LLP  
Russell Bedford Stefanou Mirchandani LLP

McLean, Virginia  
January 5, 2007

F-1

APPLIED DNA SCIENCES, INC.  
(A Development stage company)  
CONSOLIDATED BALANCE SHEET  
SEPTEMBER 30, 2006

ASSETS

Current assets:

Cash  
Accounts receivable  
Advances and other receivables  
Prepaid expenses

Total current assets

Property and equipment-net of accumulated depreciation of \$20,885 (Note A)

Other assets:

Deposits  
Capitalized finance costs-net of accumulated amortization of \$636,013

Intangible assets:

Patients, net of accumulated amortization of \$18,593 (Note B)  
Intellectual property, net of accumulated amortization of \$7,339,100 (Note B)

Total Assets

LIABILITIES AND DEFICIENCY IN STOCKHOLDERS' EQUITY

Current liabilities:

Accounts payable and accrued liabilities (Note C)  
Convertible notes payable, net of unamortized discount (Note D)  
Note payable-Related Party (Note E)

Total current liabilities

Debt derivative and warrant liability

Commitments and contingencies (Note K)

Deficiency in Stockholders' Equity- (Note F)

Preferred stock, par value \$0.001 per share; 10,000,000 shares authorized; 60,000 issued and outstanding

Common stock, par value \$0.001 per share; 250,000,000 shares authorized; 120,982,385 issued

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and outstanding  
Additional paid in capital  
Accumulated deficit

Total deficiency in stockholders' equity

Total liabilities and Deficiency in Stockholders' Equity

See the accompanying notes to the consolidated financial statements

F-2

## APPLIED DNA SCIENCES, INC. (A DEVELOPMENT STAGE COMPANY) CONSOLIDATED STATEMENTS OF LOSSES

	For the Year	Ended September 30,
	2006	2005
	-----	-----
	(RESTATE)	(RESTATE)
	-----	-----
Sales	\$ 18,900	\$ -
Cost of sales	15,639	-
	-----	-----
Gross Profit	3,261	-
Operating expenses:		
Selling, general and administrative	8,530,354	50,714,017
Research and development	153,191	638,873
Impairment of intangible asset(s)	5,655,011	-
Depreciation and amortization	1,370,299	356,266
	-----	-----
Total operating expenses	15,708,855	51,709,156
	-----	-----
NET LOSS FROM OPERATIONS	(15,705,594)	(51,709,156)
Net gain in revaluation of debt derivative and warrant liabilities	16,844,837	16,700,990
Other income	79,488	4,957
Interest expense	(3,828,968)	(32,106,310)
	-----	-----
Net loss before provision for income taxes	(2,410,237)	(67,109,519)
Income taxes (benefit)	-	-
	-----	-----
NET LOSS	\$ (2,410,237)	\$ (67,109,519)

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	=====	=====
Net loss per share-basic and fully diluted	\$ (0.02)	\$ (1.05)
	=====	=====
Weighted average shares outstanding-		
Basic and fully diluted	116,911,022	63,917,009
	-----	-----

See the accompanying notes to the consolidated financial statements

F-3

## APPLIED DNA SCIENCES, INC (A development stage company) CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY) FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2002

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
	-----	-----	-----	-----	-----	-----	-----
Issuance of common stock to Founders in exchange for services on September 16, 2002 at \$.01 per share	--	--	100,000	\$ 10	\$ 990	\$ --	\$ --
Net Loss	--	--	--	--	--	--	--
Balance at September 30, 2002	--	\$ --	100,000	\$ 10	\$ 990	\$ --	\$ --
	=====	=====	=====	=====	=====	=====	=====
Issuance of common stock in connection with merger with Prohealth Medical Technologies, Inc on October 1, 2002	--	--	10,178,352	1,015	--	--	--
Cancellation of Common stock in connection with merger with Prohealth Medical Technologies, Inc on October 21, 2002	--	--	(100,000)	(10)	(1,000)	--	--

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Issuance of common stock in exchange for services in October 2002 at \$0.65 per share	--	--	602,000	60	39,070	--	
Issuance of common stock in exchange for subscription in November and December 2002 at \$0.065 per share	--	--	876,000	88	56,852	--	(5
Cancellation of common stock in January 2003 previously issued in exchange for consulting services	--	--	(836,000)	(84)	(54,264)	--	5
Issuance of common stock in exchange for licensing services valued at \$0.065 per share in January 2003	--	--	1,500,000	150	97,350	--	
Issuance of common stock in exchange for consulting services valued at \$0.13 per share in January 2003	--	--	586,250	58	76,155	--	
Issuance of common stock in exchange for consulting services at \$0.065 per share in February 2003	--	--	9,000	1	584	--	

F-4

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2003



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	Preferred Shares -----	Preferred Shares Amount -----	Common Shares -----	Common Stock Amount -----	Additional Paid in Capital Amount -----	Common Stock Subscribed -----	Stoc Subscri Receiv -----
Issuance of common stock to Founders in exchange for services valued at \$0.0001 per share in March 2003	--	--	10,140,000	1,014	--	--	
Issuance of common stock in exchange for consulting services valued at \$2.50 per share in March 2003	--	--	91,060	10	230,624	--	
Issuance of common stock in exchange for consulting services valued at \$0.065 per share in March 2003	--	--	6,000	1	389	--	
Common stock subscribed in exchange for cash at \$1 per share in March 2003	--	--	--	--	18,000	--	
Common stock issued in exchange for consulting services at \$0.065 per share on April 1, 2003	--	--	860,000	86	55,814	--	
Common stock issued in exchange for cash at \$1.00 per share on April 9, 2003	--	--	18,000	2	--	--	
Common stock issued in exchange for consulting							

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services at \$0.065 per share on April 9, 2003	--	--	9,000	1	584	--
Common stock issued in exchange for consulting services at \$2.50 per share on April 23, 2003	--	--	5,000	1	12,499	--
Common stock issued in exchange for consulting services at \$2.50 per share, on June 12, 2003	--	--	10,000	1	24,999	--
Common stock issued in exchange for cash at \$1.00 per share on June 17, 2003	--	--	50,000	5	49,995	--
Common stock subscribed in exchange for cash at \$2.50 per share pursuant to private placement on June 27, 2003	--	--	--	--	--	24,000

F-5

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2003

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
Common stock retired in exchange for note payable at \$0.0118 per							

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share, in June 30, 2003	--	--	(7,500,000)	(750)	750	--
Common stock issued in exchange for consulting services at \$0.065 per share, on June 30, 2003	--	--	270,000	27	17,523	--
Common stock subscribed in exchange for cash at \$1.00 per share pursuant to private placement on June 30, 2003	--	--	--	--	--	10,000
Common stock subscribed in exchange for cash at \$2.50 per share pursuant to private placement on June 30, 2003	--	--	--	--	--	24,000
Common stock issued in exchange for consulting services at approximately \$2.01 per share, July 2003	--	--	213,060	21	428,798	--
Common stock canceled in July 2003, previously issued for services rendered at \$2.50 per share	--	--	(24,000)	(2)	(59,998)	--
Common stock issued in exchange for options exercised at \$1.00 per share in July 2003	--	--	20,000	2	19,998	--
Common stock issued in						

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exchange for exercised of options previously subscribed at \$1.00 per share in July 2003	--	--	10,000	1	9,999	(10,000)
Common stock issued in exchange for consulting services at approximately \$2.38 per share, August 2003	--	--	172,500	17	410,915	--
Common stock issued in exchange for options exercised at \$1.00 per share in August 2003	--	--	29,000	3	28,997	--
Common stock issued in exchange for consulting services at approximately \$2.42 per share, September 2003	--	--	395,260	40	952,957	--

F-6

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2003

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
Common stock issued in exchange for cash at \$2.50 per share- subscription payable-							

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September 2003	--	--	19,200	2	47,998	(48,000)	
Common stock issued in exchange for cash at \$2.50 per share pursuant to private placement							
September 2003	--	--	6,400	1	15,999	--	
Common stock issued in exchange for options exercised at \$1.00 per share in							
September 2003	--	--	95,000	10	94,991	--	
Common stock subscriptio receivable reclassificat adjustment	--	--	--	--	--	--	
Common Stock subscribed to at \$2.50 per share in							
September 2003	--	--	--	--	--	300,000	
Net Loss for the year ended September 30, 2003	--	--	--	--	--	--	
Balance at September 30, 2003	--	\$ --	17,811,082	\$ 1,781	\$ 2,577,568	\$ 300,000	\$
Preferred shares issues in exchange for services at \$25.00 per share,							
October 2003	15,000	15	--	--	--	--	
Common stock issued in exchange for consulting services at approximately \$2.85 per share, October							
2003	--	--	287,439	29	820,389	--	

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Common stock issued in exchange for cash at \$2.50 per share- subscription payable- October 2003	--	--	120,000	12	299,988	(300,000)
Common stock canceled in October 2003, previously issued for services rendered at \$2.50 per share	--	--	(100,000)	(10)	(249,990)	--
Common stock issued in exchange for consulting services at approximately \$3 per share, November 2003	--	--	100,000	10	299,990	--

F-7

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2003

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
Common stock subscribed in exchange for cash at \$2.50 per share pursuant to private placement, November, 2003	--	--	100,000	10	249,990	--	
Common stock subscribed in exchange for cash at \$2.50 per share pursuant to							

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private placement, December, 2003	--	--	6,400	1	15,999	--
Common stock issued in exchange for consulting services at approximately \$2.59 per share, December 2003	--	--	2,125,500	213	5,504,737	--
Common Stock subscribed to at \$2.50 per share in December 2003	--	--	--	--	--	104,000
Beneficial conversion feature relating to notes payable	--	--	--	--	1,168,474	--
Beneficial conversion feature relating to warrants	--	--	--	--	206,526	--
Adjust common stock par value from \$0.0001 to \$0.50 per share, per amendment of articles dated in December 200	--	--	--	10,223,166	(10,223,166)	--
Common Stock issued pursuant to subscription at \$2.50 share in January 2004	--	--	41,600	20,800	83,200	(104,000)
Common stock issued in exchange for consulting services at \$2.95 per share, January 2004	--	--	13,040	6,520	31,948	--
Common stock issued in exchange for consulting services at \$2.60 per						

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share, January 2004	--	--	123,000	61,500	258,300	--
Common stock issued in exchange for consulting services at \$3.05 per share, January 2004	--	--	1,000	500	2,550	--
Common stock issued in exchange for employee services at \$3.07 per share, February 2004	--	--	6,283	3,142	16,147	--
Common stock issued in exchange for consulting services at \$3.04 per share, March 2004	--	--	44,740	22,370	113,640	--
Common Stock issued for options exercised at \$1.00 per share in March 2004	--	--	55,000	27,500	27,500	--

F-8

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2003

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
Common stock issued in exchange for employee services at \$3.00 per share, March							



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2004	--	--	5,443	2,722	13,623	--
Common stock issued in exchange for employee services at \$3.15 per share, March 2004	--	--	5,769	2,885	15,292	--
Preferred shared converted to common shares for consulting services at \$3.00 per share, March 2004	(5,000)	(5)	125,000	62,500	312,500	--
Common stock issued in exchange for employee services at \$3.03 per share, March 2004	--	--	8,806	4,400	22,238	--
Common Stock issued pursuant to subscription at \$2.50 per share in March 2004	--	--	22,500	11,250	(9,000)	--
Beneficial Conversion Feature relating to Notes Payable	--	--	122,362	--	--	--
Beneficial Conversion Feature relating to Warrants	--	--	--	--	177,638	--
Common stock issued in exchange for consulting services at \$2.58 per share, April 2004	--	--	9,860	4,930	20,511	--
Common stock issued in exchange for consulting						

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services at \$2.35 per share, April 2004	--	--	11,712	5,856	21,667	--
Common stock issued in exchange for consulting services at \$1.50 per share, April 2004	--	--	367,500	183,750	367,500	--
Common stock returned to treasury at \$0.065 per share, April 2004	--	--	(50,000)	(25,000)	21,750	--
Preferred stock converted to common stock for consulting services at \$1.01 per share in May 2004	(4,000)	(4)	100,000	50,000	51,250	--
Common stock issued per subscription May 2004	--	--	10,000	5,000	(4,000)	--
Common stock issued in exchange for consulting services at \$0.86 per share in May 2004	--	--	137,000	68,500	50,730	--

F-9

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2003

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
Common stock	-----	-----	-----	-----	-----	-----	-----

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issued in exchange for consulting services at \$1.15 per share in May 2004	--	--	26,380	13,190	17,147	--
Common stock returned to treasury at \$0.065 per share, June 2004	--	--	(5,000)	(2,500)	2,175	--
Common stock issued in exchange for consulting services at \$0.67 per share in June 2004	--	--	270,500	135,250	45,310	--
Common stock issued in exchange for consulting services at \$0.89 per share in June 2004	--	--	8,000	4,000	3,120	--
Common stock issued in exchange for consulting services at \$0.65 per share in June 2004	--	--	50,000	25,000	7,250	--
Common stock issued pursuant to private placement at \$1.00 per share in June 2004	--	--	250,000	125,000	125,000	--
Common stock issued in exchange for consulting services at \$0.54 per share in July 2004	--	--	100,000	50,000	4,000	--
Common stock issued in exchange for consulting services at						

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\$0.72 per share in July 2004	--	--	5,000	2,500	1,100	--
Common stock issued in exchange for consulting services at \$0.47 per share in July 2004	--	--	100,000	50,000	(2,749)	--
Common stock issued in exchange for consulting services at \$0.39 per share in August 2004	--	--	100,000	50,000	(11,000)	--
Preferred stock converted to common stock for consulting services at \$0.39 per share in August 2004	(2,000)	(2)	50,000	25,000	(5,500)	--
Common stock issued in exchange for consulting services at \$0.50 per share in August 2004	--	--	100,000	50,000	250	--
Common stock issued in exchange for consulting services at \$0.56 per share in August 2004	--	--	200,000	100,000	12,500	--

F-10

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2003

Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
-----	-----	-----	-----	-----	-----	-----
Common stock						

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issued in exchange for consulting services at \$0.41 per share in August 2004	--	--	92,500	46,250	(8,605)	--
Common stock issued in exchange for consulting services at \$0.52 per share in September 2004	--	--	1,000,000	500,000	17,500	--
Common stock issued in exchange for consulting services at \$0.46 per share in September 2004	--	--	5,000	2,500	(212)	--
Common stock issued pursuant to subscription at \$0.50 per share in September 2004	--	--	40,000	20,000	--	--
Preferred shares converted to common stock for consulting services at \$0.41 per share in September 2004	(4,000)	(4)	100,000	50,000	4,000	--
Preferred shares issued in exchange for service at \$25 per share in September 2004	60,000	6	--	--	1,499,994	--
Fair value of 2,841,000 warrants issued to non employees and consultants for services rendered at approximately \$0.71 per warrant in September 200	--	--	--	--	2,019,862	--

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Net Loss	--	--	--	--	--	--	--
Balance at September 30, 2004	60,000	\$ 6	23,981,054	\$11,990,527	\$ 6,118,993	\$ --	\$ (
	=====	=====	=====	=====	=====	=====	=====
Common stock issued in exchange for consulting services at \$0.68 per share in October 2004	--	--	200,000	100,000	36,000	--	
Common stock returned to treasury at \$0.60 per share in October 2004	--	--	(1,069,600)	(534,800)	(107,297)	--	
Common stock issued in exchange for consulting services at \$0.60 per share in October 2004	--	--	82,500	41,250	8,250	--	

F-11

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2004

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
	-----	-----	-----	-----	-----	-----	-----
Common Stock issued pursuant to subscription at \$0.60 per share in October 2004	--	--	500,000	250,000	50,000	(300,000)	
Common stock issued in exchange for consulting services at \$0.50 per share in October 2004	--	--	532,500	266,250	--	--	

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Common Stock issued in exchange for debt at \$0.50 per share in October 2004	--	--	500,000	250,000	--	--
Common Stock issued pursuant to subscription at \$0.45 per share in October 2004	--	--	1,000,000	500,000	(50,000)	(450,000)
Common stock issued in exchange for consulting services at \$0.45 per share in October 2004	--	--	315,000	157,500	(15,750)	--
Common Stock issued in exchange for consulting services at \$0.47 per share in November 2004	--	--	100,000	50,000	(3,000)	--
Common Stock issued in exchange for consulting services at \$0.80 per share in November 2004	--	--	300,000	150,000	90,000	--
Common Stock issued in exchange for consulting services at \$1.44 per share in November 200	--	--	115,000	57,500	108,100	--
Common Stock issued in exchange for employee services at \$1.44 per share in November 2004	--	--	5,000	2,500	4,700	--
Warrants exercised at \$0.60 per share in November 2004	--	--	60,000	30,000	6,000	(4,000)

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Beneficial Conversion discount relating to Notes Payable	--	--	--	--	1,465,000	--
Common stock issued at \$0.016 per share in exchange for note payable in December 2004	--	--	5,500,000	2,750,000	(2,661,500)	--
Common stock issued in settlement of debt at \$0.50 per share in December 2004	--	--	2,930,000	1,465,000	--	(125,000)

F-12

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2004

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
Fair value of 6,063,500 warrants issued to non employee and consultants for services rendered at \$0.52 per warrant in October and December 2004	--	--	--	--	3,169,052	--	
Warrants exercised at \$0.10 per share in January 2005	--	--	25,000	12,500	(10,000)	--	
Common Stock issued in settlement of debt at \$0.33 per share in							



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January 2005	--	--	1,628,789	814,395	(276,895)	--
Warrants exercised at \$0.10 per share in January 2005	--	--	17,500	8,750	(7,000)	--
Common Stock issued in settlement of debt at \$0.33 per share in January 2005	--	--	2,399,012	1,199,504	(407,830)	--
Common Stock issued in exchange for consulting services at \$1.30 per share in January 2005	--	--	315,636	157,818	252,508	--
Fair value of warrant liability reclassified due to registration rights granted in February 2005	--	--	--	--	(3,108,851)	--
Common Stock issued in exchange for consulting services at \$1.44 per share in February 200	--	--	5,796,785	2,898,393	5,418,814	--
Fair value of 55,000 warrants issued to consultants for services at \$1.31 per warrant in February 2005	--	--	--	--	72,017	--

F-13

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2003

Preferred	Common	Additional Paid in	Common	Stock
-----------	--------	--------------------	--------	-------

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	Preferred Shares -----	Shares Amount -----	Common Shares -----	Stock Amount -----	Capital Amount -----	Stock Subscribed -----	Subscri Receiv -----
Common Stock issued in settlement of debt at \$0.33 per share in February 2005	--	--	75,757	37,879	(12,879)	--	
Warrants exercised at \$0.10 per share in February 2005	--	--	20,000	10,000	(8,000)	--	
Common Stock issued in settlement of debt at \$0.33 per share in February 2005	--	--	606,060	303,030	(103,030)	--	
Warrants exercised at \$0.10 per share in February 2005	--	--	45,000	22,500	(18,000)	--	
Common Stock issued in exchange for related party debt at \$1.31 per share in February 2005	--	--	1,500,000	750,000	1,215,000	--	
Common Stock issued in settlement of debt at \$0.33 per share in February 2005	--	--	278,433	139,217	(47,334)	--	
Common Stock issued in exchange for consulting services at \$1.17 per share in February 200	--	--	17,236	8,618	11,548	--	
Common stock issued in exchange for debt at \$0.50 per share in February 2005	--	--	300,000	150,000	--	--	
Common Stock issued in							

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exchange for consulting services at \$0.95 per share in February 2005	--	--	716,500	358,250	322,425	--
Common Stock issued in exchange for consulting services at \$0.95 per share in February 2005	--	--	10,500	5,250	4,725	--
Common stock issued in exchange for debt at \$0.50 per share in March 2005	--	--	13,202,000	6,601,000	--	--
Common Stock issued in exchange for consulting services at \$1.19 per share in March 2005	--	--	185,000	92,500	127,650	--
Options exercised at \$0.60 per share in March 2005	--	--	100,000	50,000	10,000	--
Common Stock issued in exchange for consulting services at \$0.98 per share in March 2005	--	--	1,675,272	837,636	804,131	--
Common Stock issued in exchange for consulting services at \$0.92 per share in March 2005	--	--	24,333	12,167	10,219	--
Common Stock issued in exchange for consulting services at \$0.99 per share in March 2005	--	--	15,000	7,500	7,350	--
Common stock issued in						

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exchange for debt at \$0.50 per share in March 2005	--	--	1,240,000	620,000	--	--
Common stock canceled for shares issued in exchange of debt in March 2005	--	--	(500,000)	(250,000)	--	--

F-14

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2005

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
	-----	-----	-----	-----	-----	-----	-----
Common stock subscribed Canceled in March 2005	--	--	--	--	--	750,000	
Common Stock issued in exchange for consulting services at \$0.89 per share in March 2005	--	--	10,000	5,000	3,900	--	
Adjust common stock par value from \$0.50 to \$0.001 per share, per amendment of articles dated March-05	--	--	--	(32,312,879)	32,312,879	--	
Beneficial Conversion discount relating to Notes Payable in March 2005	--	--	--	--	7,371,000	--	
Stock options granted to employees in							

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exchange for services rendered, at exercise price below fair value of common stock in March 2005	--	--	--	--	180,000	--
Common Stock issued in exchange for consulting services at \$0.80 per share in April 2005	--	--	160,000	160	127,840	--
Common Stock issued in exchange for consulting services at \$0.80 per share in April 2005	--	--	40,000	40	31,960	--
Common Stock issued in exchange for consulting services at \$0.75 per share in April 2005	--	--	850,000	850	636,650	--
Common Stock issued in exchange for consulting services at \$0.33 per share in April 2005	--	--	500,000	500	164,500	--
Common Stock canceled during April 2005, previously issued for services rendered at \$3.42 per share	--	--	(10,000)	(10)	(34,190)	--
Common Stock issued in settlement of debt at \$0.33 per share in April 2005	--	--	75,758	77	24,923	(25,000)
Common Stock issued in exchange for						

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consulting services at \$0.68 per share in April 2005	--	--	50,000	50	33,950	--
Proceeds received against subscription Payable in June 2005	--	--	--	--	--	118,000

F-15

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2005

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
Common Stock canceled in June 2005, previously issued for services rendered at \$0.50 per share	--	--	(10,000)	(10)	(4,990)	--	
Cancellation of previously granted stock options granted to employees for services rendered, at exercise price below fair value of common stock	--	--	--	--	(180,000)	--	
Common Stock issued in exchange for consulting services at \$0.60 per share in July 2005	--	--	157,000	157	94,043	--	
Common Stock issued in exchange for							

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intellectual property at \$0.67 per share in July 2005	--	--	36,000,000	36,000	24,084,000	--
Common Stock issued in exchange for consulting services at \$0.60 per share in July 2005	--	--	640,000	640	383,360	--
Common Stock issued in exchange for employee services at \$0.48 per share in July 2005	--	--	8,000,000	8,000	3,832,000	--
Common Stock issued in exchange for consulting services at \$0.94 per share in July 2005	--	--	121,985	121	168,217	--
Common Stock issued in exchange for consulting services at \$0.48 per share in August 2005	--	--	250,000	250	119,750	--
Common Stock penalty shares issued pursuant to pending SB-2 registration at \$0.62 per share in September 2005	--	--	814,158	814	501,858	--
Common Stock penalty shares issued pursuant to pending SB-2 registration at \$0.70 per share in September 2005	--	--	391,224	391	273,466	--
Common Stock issued in exchange for consulting services at \$0.94 per share in September						

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2005                      --                      --                      185,000                      185                      173,715                      --

F-16

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2005

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
Common Stock returned in September 2005, previously issued for services rendered at \$0.40 per share	--	--	(740,000)	(740)	(453,232)	56,000	
Net Loss	--	--	--	--	--	--	
Balance as of September 30, 2005	60,000	\$ 6	112,230,392	\$ 112,230	\$82,320,715	\$ 20,000	\$
Common stock issued in exchange for services at \$0.50 per share in October 2005	--	--	400,000	400	199,600	--	
Common Stock issued in exchange for consulting services at \$0.75 per share in October 2005	--	--	100,000	100	74,900	--	
Common Stock returned in October 2005, previously issued for services rendered at \$0.60 per share	--	--	(350,000)	(350)	(209,650)	--	
Common stock issued pursuant							



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to subscription at \$0.50 per share in December 2005	--	--	40,000	40	19,960	(20,000)
Common Stock to investors pursuant to registration rights agreement at \$0.51 per share in December 2005	--	--	505,854	506	257,480	--
Common Stock returned in January 2006, previously issued for services rendered at \$0.60 per share	--	--	(250,000)	(250)	(149,750)	--
Common Stock issued to investors pursuant to registration rights agreement at \$0.32 per share in January 2006	--	--	806,212	806	257,182	--
Common Stock issued to investors pursuant to registration rights agreement at \$0.20 per share in January 2006	--	--	1,289,927	1,290	256,695	--
Fair value of 200,000 warrants issued to consultants for services at \$0.22 per warrant in January 2006	--	--	--	--	43,098	--

F-17

APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)

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FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH SEPTEMBER 30, 2006

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscri Receiv
-----	-----	-----	-----	-----	-----	-----	-----
Common Stock issued in exchange for consulting services at \$0.17 per share in February 2006	--	--	160,000	160	27,040	--	
Common Stock issued in exchange for consulting services at \$0.16 per share in February 2006	--	--	3,800,000	3,800	604,200	--	
Common Stock returned in March 2006, previously issued for services rendered at \$0.80 per share	--	--	(150,000)	(150)	(119,850)	--	
Previously issued warrants reclassified to warrant liability	--	--	--	--	(1,584,614)	--	
Common Stock issued in exchange for consulting services at \$0.20 per share in July 2006	--	--	2,400,000	2,400	477,600	--	
Fair value of stock options granted to employees in exchange for services rendered in September 2006	--	--	--	--	153,000	--	
Net loss	--	--	--	--	--	--	
-----	-----	-----	-----	-----	-----	-----	-----

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Balance as of  
September  
30, 2006

60,000	\$	6	\$120,982,385	\$	120,982	\$82,627,606	\$	--	\$
=====	=====	=====	=====	=====	=====	=====	=====	=====	=====

See accompanying notes to consolidated financial statements

F-18

## APPLIED DNA SCIENCES, INC (A DEVELOPMENT STAGE COMPANY) CONSOLIDATED STATEMENT OF CASH FLOWS

	For the year ended September 30, 2006	
	2006	(REVENUE)
Cash flows from operating activities:		
Net loss	\$ (2,410,237)	\$ (67,000)
Adjustments to reconcile net loss to net used in operating activities:		
Depreciation and amortization	1,370,299	
Organization expenses	-	
Impairment of intangible assets	5,655,011	
Preferred shares issued in exchange for services	-	
Options and warrants issued in exchange for services rendered	1,622,825	7,000
Income attributable to re pricing of warrants and debt derivatives	(16,844,837)	(16,844,837)
Financing costs attributable to issuance of warrants	2,271,000	23,000
Amortization of beneficial conversion feature-convertible notes	-	8,000
Amortization of capitalized financing costs	636,013	
Amortization of debt discount attributable to convertible debentures	731,490	
Debt in exchange for common stock at fair market price	-	1,000
Common stock issued in exchange for services rendered	1,390,200	18,000
Common stock exchanged for intellectual property in connection with costs of acquiring intangible assets	-	14,000
Common stock issued in connection with penalties pursuant to registration	773,958	
Common stock canceled-previously issued for services rendered	(480,000)	
Change in assets and liabilities:		
Increase in accounts receivable	(5,621)	
Increase in prepaid expenses and deposits	(106,667)	
Decrease in other assets	440	
Decrease in due related parties	-	
Increase (decrease) in accounts payable and accrued liabilities	2,512,312	
Net cash used in operating activities	(2,883,815)	(9,000)
Cash flows from investing activities:		
Payments for patent filing	-	
Acquisition (disposal) of property and equipment, net	(164,571)	
Net cash provided by (used in) investing activities	(164,571)	

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See the accompanying notes to the consolidated financial statements

F-19

## APPLIED DNA SCIENCES, INC (A DEVELOPMENT STAGE COMPANY) CONSOLIDATED STATEMENT OF CASH FLOWS

	For the year ended September 30, 2005	
	2006	(RESTATED)
Cash flows from financing activities:		
Proceeds from sale of common stock, net of cost	-	-
Proceeds from issuance of convertible notes	4,242,500	9,079,000
Proceeds from sale of options	-	102,750
Repayment of debt	-	(24,854)
Proceeds from loans	-	-
Advances from shareholders	-	-
Net cash provided by financing activities	4,242,500	9,156,896
Net increase in cash and cash equivalents	1,194,114	29,358
Cash and cash equivalents at beginning of period	31,190	1,832
Cash and cash equivalents at end of period	\$ 1,225,304	\$ 31,190
Supplemental Disclosures of Cash Flow Information:		
Cash paid during period for interest	-	-
Cash paid during period for taxes	-	-
Non-cash transactions:		
Common stock issued for services	1,390,200	18,176,641
Common stock issued in exchange for intellectual property	-	9,430,900
Common stock issued in exchange for previously incurred debt	-	3,109,533
Common stock canceled-previously issued for services rendered	(480,000)	(578,270)
Common stock issued for ESOP shares		3,960,000
Common stock penalty shares issued pursuant to Pending SB-2 registration		776,529
Amortization of beneficial conversion feature		8,836,000
Preferred shares in exchange for service at \$25 per share in September 2004	-	-
Fair value of options and warrants issued to consultants for services	1,622,825	7,358,568
Acquisition:		
Common stock retained	-	1,015
Assets acquired	-	(135)

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Total consideration paid

-

880

Organizational expenses-note issued in exchange for shares retired  
Common stock issued in exchange for note payable

See the accompanying notes to the consolidated financial statements

F-20

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

### NOTE A -- SUMMARY OF ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the preparation of the accompanying financial statements follows.

#### Business and Basis of Presentation

On September 16, 2002, Applied DNA Sciences, Inc. (the "Company") was incorporated under the laws of the State of Nevada. The Company is in the development stage, as defined by Statement of Financial Accounting Standards No. 7 ("SFAS No. 7") and its efforts have been principally devoted to developing DNA embedded biotechnology security solutions in the United States. To date, the Company has generated nominal sales revenues, has incurred expenses and has sustained losses. Consequently, its operations are subject to all the risks inherent in the establishment of a new business enterprise. For the period from inception through September 30, 2006, the Company has accumulated losses of \$92,334,791.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Applied DNA Operations Management, Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

#### Estimates

The preparation of the financial statement in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

#### Revenue Recognition

The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the selling price is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) are based on management's judgments regarding the fixed nature of the selling prices of the products delivered and the collectibility of those amounts. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments are provided for in the same period the related sales are recorded.

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On December 17, 2003, the SEC staff released Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. The staff updated and revised the existing revenue recognition in Topic 13, Revenue Recognition, to make its interpretive guidance consistent with current accounting guidance, principally EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." Also, SAB 104 incorporates portions of the Revenue Recognition in Financial Statements - Frequently Asked Questions and Answers document that the SEC staff considered relevant and rescinds the remainder. The company's revenue recognition policies are consistent with this guidance; therefore, this guidance will not have an immediate impact on the company's consolidated financial statements.

### Cash Equivalents

For the purpose of the accompanying financial statements, all highly liquid investments with a maturity of three months or less are considered to be cash equivalents.

F-21

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

### NOTE A - SUMMARY OF ACCOUNTING POLICIES (continued)

#### Income Taxes

The Company has adopted Financial Accounting Standard No. 109 (SFAS 109) which requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statement or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Temporary differences between taxable income reported for financial reporting purposes and income tax purposes are insignificant.

#### Property and Equipment

Property and equipment are stated at cost and depreciated over their estimated useful lives of 3 to 5 years using the straight line method. At September 30, 2006 property and equipment consist of:

	2006
	-----
Computer equipment	\$20,065
Lab equipment	51,273
Furniture	105,984
	-----
	177,322
Accumulated Depreciation	(20,885)
	-----
Net	\$156,437

#### Impairment of Long-Lived Assets

The Company has adopted Statement of Financial Accounting Standards No. 144 (SFAS 144). The Statement requires that long-lived assets and certain identifiable intangibles held and used by the Company be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Events relating to recoverability may include significant unfavorable changes in business conditions, recurring losses, or a forecasted inability to achieve break-even operating results over an extended period. The Company evaluates the recoverability of long-lived assets based upon forecasted undercounted cash flows. Should impairment in value be indicated, the carrying value of intangible assets will be adjusted, based on estimates of future discounted cash flows resulting from the use and ultimate disposition of the asset. SFAS No. 144 also requires assets to be disposed of be reported at the lower of the carrying amount or the fair value less costs to sell.

During the year ended September 30, 2006, the Company management performed an evaluation of its intangible assets (intellectual property) for purposes of determining the implied fair value of the assets at September 30, 2006. The test indicated that the recorded remaining book value of its intellectual property exceeded its fair value, as determined by discounted cash flows. As a result, upon completion of the assessment, management recorded a non-cash impairment charge of \$5,655,011, net of tax, or \$0.05 per share during the year ended September 30, 2006 to reduce the carrying value of the patents to \$2,091,800. Considerable management judgment is necessary to estimate the fair value. Accordingly, actual results could vary significantly from management's estimates (See Note B).

#### Comprehensive Income

The Company does not have any items of comprehensive income in any of the periods presented.

F-22

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

#### NOTE A - SUMMARY OF ACCOUNTING POLICIES (continued)

##### Segment Information

The Company adopted Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information ("SFAS 131"). SFAS establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to stockholders. SFAS 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision making group, in making decisions how to allocate resources and assess performance. The information disclosed herein, materially represents all of the financial information related to the Company's principal operating segment.

#### Net Loss Per Share

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The Company has adopted Statement of Financial Accounting Standard No. 128, "Earnings Per Share," specifying the computation, presentation and disclosure requirements of earnings per share information. Basic earnings per share has been calculated based upon the weighted average number of common shares outstanding. Stock options and warrants have been excluded as common stock equivalents in the diluted earnings per share because they are either antidilutive, or their effect is not material. Fully diluted shares outstanding were 199,930,486 and 112,230,392 for the years ended September 30, 2006 and 2005, respectively.

### Stock Based Compensation

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure-an amendment of SFAS 123." This statement amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No. 25 and related interpretations. Accordingly, compensation expense for stock options is measured as the excess, if any, of the fair market value of the Company's stock at the date of the grant over the exercise price of the related option. The Company has adopted the annual disclosure provisions of SFAS No. 148 in its financial reports for the year ended September 30, 2006 and for the subsequent periods. The Company issued employee unvested employee options as stock-based compensation during the year ended September 30, 2006 and therefore has no unrecognized stock compensation related liabilities ended September 30, 2006. On January 1, 2006, we adopted the fair value recognition provisions of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 123, Accounting for Stock Based Compensation, to account for compensation costs under our stock option plans. We previously utilized the intrinsic value method under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (as amended) ("APB 25"). Under the intrinsic value method prescribed by APB 25, no compensation costs were recognized for our employee stock options because the option exercise price equaled the market price on the date of the grant. Prior to January 1, 2006 we only disclosed the pro forma effects on net income and earnings per share as if the fair value recognition provisions of SFAS 123(R) had been utilized.

F-23

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

### NOTE A - SUMMARY OF ACCOUNTING POLICIES (continued)

In adopting SFAS No. 123(R), we elected to use the modified prospective method to account for the transition from the intrinsic value method to the fair value recognition method. Under modified prospective method, compensation cost is recognized from the adoption date forward for all new stock options granted and for any outstanding unvested awards as if the fair value method had been applied to those awards as of the date of the grant. In the year ended September 30,



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2006; the Company granted employee stock options vesting from the date of service.. The fair value of \$153,000 was recorded as a charge to operations.

The following table shows the effect on net earnings and earnings per share had compensation cost been recognized based upon the estimated fair value on the grant date of stock options for year ended September 30, 2005, in accordance with SFAS 123, as amended by SFAS No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure":

		For the Period September, 16 2002 (Date of
	For The Year ended Sept 30	Inception through
	2005 (RESTATED)	Sept 30, 2005 (RESTATED)
	-----	-----
Net loss - as reported	\$ (67,109,519)	\$ (92,334,791)
Add: Total stock based employee compensation expense as reported under intrinsic value method ( APB No. 25)	-	-
Deduct: Total stock based employee compensation expense as reported under fair value method ( APB No. 123)	(1,406,350)	(1,406,350)
	-----	-----
Net loss - Pro Forma	\$ (68,515,869)	\$ (93,741,141)
	=====	=====
Net loss attributable to common stockholders - Pro Forma	\$ (68,515,869)	\$ (93,741,141)
	=====	=====
Basic (and assuming dilution) loss per share - as reported	\$ (1.05)	
	=====	=====
Basic (and assuming dilution) loss per share - Pro Forma	\$ (1.08)	
	=====	=====

### Liquidity

As shown in the accompanying financial statements, the Company incurred a net loss of \$92,334,791 during the period September 16, 2002 (date of inception) through September 30, 2006. The Company's current liabilities exceeded its current assets by \$8,382,211 as of September 30, 2006.

F-24

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

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### NOTE A - SUMMARY OF ACCOUNTING POLICIES (continued)

#### Concentrations of Credit Risk

Financial instruments and related items, which potentially subject the Company to concentrations of credit risk, consist primarily of cash, cash equivalents and trade receivables. The Company places its cash and temporary cash investments with high credit quality institutions. At times, such investments may be in excess of the FDIC insurance limit. The Company periodically reviews trade receivables in determining its allowance for doubtful accruals. The allowance for doubtful accruals at September 30, 2006 was \$0.

#### Research and Development

The Company accounts for research and development costs in accordance with the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 2 ("SFAS 2"), "Accounting for Research and Development Costs. Under SFAS 2, all research and development costs must be charged to expense as incurred. Accordingly, internal research and development costs are expensed as incurred. Third-party research and development costs are expensed when the contracted work has been performed or as milestone results have been achieved. Company-sponsored research and development costs related to both present and future products are expensed in the period incurred. The Company incurred research and development expenses of \$153,191, \$638,873 and \$1,030,599 for the years ended September 30, 2006, September 30, 2005 and from September 16, 2002 (date of inception) through September 30, 2006, respectively. On July 12, 2005, the Company exchanged 36 million shares of stock with a value of \$24,120,000 for intellectual property acquired from Biowell Technology, Inc. (see Note B). The Company capitalized \$9,430,900 as an intangible asset and expensed \$14,689,100 to acquisition costs in the year ended September 30, 2005.

#### Advertising

The Company follows the policy of changing the cost of advertising to expenses as accrued. For the years ended September 30, 2005 and 2005, advertising costs were not material to the statement of losses.

#### Reclassifications

Certain reclassifications have been made in prior year's financial statements to conform to classifications used in the current year.

#### Intangible Assets

The Company amortized its intangible assets using the straight-line method over their estimated period of benefit. The estimated useful life for patents is five years while intellectual property uses a seven year useful life. We periodically evaluate the recoverability of intangible assets and take into account events or circumstances that warrant revised estimates of useful lives or that indicate that impairment exists. All of our intangible assets are subject to amortization.

F-25

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### NOTE A - SUMMARY OF ACCOUNTING POLICIES (continued)

#### Derivative Financial Instruments

The Company's derivative financial instruments consist of embedded derivatives related to the 10% Secured Convertible Promissory Notes (the "Serial Notes") entered into in 2006 (see Note D). These embedded derivatives include certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company recorded the derivatives and related warrants at their fair values as of the inception date of the Note Agreement (estimated at \$2,419,719) and at fair value as of each subsequent balance sheet date. In addition, under the provisions of EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," as a result of entering into the Notes, the Company is required to classify all other non-employee stock options and warrants as derivative liabilities and mark them to market at each reporting date. The fair value of such options and warrants that were reclassified as liabilities from additional paid-in capital in the year ended September 30, 2006 totaled \$730,111. Any change in fair value will be recorded as non-operating, non-cash income or expense at each reporting date. If the fair value of the derivatives is higher at the subsequent balance sheet date, the Company will record a non-operating, non-cash charge. If the fair value of the derivatives is lower at the subsequent balance sheet date, the Company will record non-operating, non-cash income. Conversion-related derivatives were valued using the Binomial Option Pricing Model with the following assumptions: dividend yield of 0%; annual volatility of 111 to 112%; and risk free interest rate of 4.96 to 5.15% as well as probability analysis related to trading volume restrictions. The remaining derivatives were valued using discounted cash flows and probability analysis. The derivatives are classified as long-term liabilities (see Note F).

In June 2005, the Financial Accounting Standards Board Emerging Issues Task Force issued EITF 05-04, "The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument Subject to EITF Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock". Under EITF 05-04, liquidated damages clauses may qualify as freestanding financial instruments for treatment as a derivative liability. Furthermore, EITF 05-04 addresses the question of whether a registration rights agreement should be combined as a unit with the underlying financial instruments and be evaluated as a single instrument. EITF 05-04 doesn't reach a consensus on this question and allows for treatment as a combined unit (Views A and B) as well as separate freestanding financial instruments (View C). On September 15, 2005, the FASB staff postponed further discussion of EITF 05-04. As of September 30, 2006, the FASB has still not rescheduled EITF 05-04 for discussion.

In connection with the issuance of the convertible notes and related warrants (see Note D), we granted liquidated damages pursuant to a separate registration rights agreement. The Company adopted View C of EITF 05-04. Accordingly, the liquidated damages pursuant to this registration rights agreement were evaluated as a stand alone financial instrument. This treatment did not have a significant different effect than if the Company would have adopted View A or B, because the warrants were classified as derivative liabilities. The Company believes that should the FASB staff reach a consensus on EITF 05-04 and select combined treatment (View A or B), the warrants will have to be evaluated as a combined unit with the liquidated damages pursuant to the registration rights agreement, and accordingly, be evaluated as derivative liabilities. The Company does not believe that its measurement of the derivative liabilities under View A or View B would significantly differ from its measurement of the derivative liabilities under View C in these circumstances.

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

NOTE A - SUMMARY OF ACCOUNTING POLICIES (continued)

New Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, "Accounting for certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140," or SFAS No. 155. SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement No. 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends SFAS No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. We do not expect the adoption of SFAS 155 to have a material impact on our consolidated financial position, results of operations or cash flows.

In March 2006, the FASB issued FASB Statement No. 156, Accounting for Servicing of Financial Assets - an amendment to FASB Statement No. 140. Statement 156 requires that an entity recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a service contract under certain situations. The new standard is effective for fiscal years beginning after September 15, 2006. The adoption of SFAS No.156 did not have a material impact on the Company's financial position and results of operations.

In July 2006, the FASB issued Interpretation No. 48 (FIN 48). "Accounting for uncertainty in Income Taxes". FIN 48 clarifies the accounting for Income Taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition and clearly scopes income taxes out of SFAS 5, "Accounting for Contingencies". FIN 48 is effective for fiscal years beginning after December 15, 2006. We have not yet evaluated the impact of adopting FIN 48 on our consolidated financial position, results of operations and cash flows.

In September 2006 the Financial Account Standards Board (the "FASB") issued its Statement of Financial Accounting Standards 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. FAS 157 effective date is for fiscal

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years beginning after November 15, 2007. The Company does not expect adoption of this standard will have a material impact on its financial position, operations or cash flows.

In September 2006 the FASB issued its Statement of Financial Accounting Standards 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans". This Statement improves financial reporting by requiring an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This Statement also improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. The effective date for an employer with publicly traded equity securities is as of the end of the fiscal year ending after December 15, 2006. The Company does not expect adoption of this standard will have a material impact on its financial position, operations or cash flows

F-27

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

### NOTE B - ACQUISITION OF INTANGIBLE ASSETS

The Company has adopted SFAS No. 142, Goodwill and Other Intangible Assets, whereby the Company periodically test its intangible assets for impairment. On an annual basis, and when there is reason to suspect that their values have been diminished or impaired, these assets are tested for impairment, and write-downs will be included in results from operations.

Biowell Technology, Inc.

On July 12, 2005, the Company acquired certain intellectual properties from Biowell Technology, Inc. ("Biowell") through an Asset Purchase Agreement ("Agreement") in exchange for 36 million shares of the Company's restricted common stock having an aggregate fair value at the date of issuance of \$24,120,000. The intangible assets acquired consist of proprietary DNA anti-counterfeit trade secrets created by Biowell that are intended to protect intellectual property from counterfeiting, fraud, piracy, product diversion and unauthorized intrusion.

The purchase price has been allocated as follows:

Amortizable intangible assets acquired are comprised of:

Developed core technologies	\$ 2,260,900
Developed product technologies	7,170,000
	-----
Total amortizable intangible assets	\$ 9,430,900
Transaction costs	14,869,100
	-----

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Total purchase price	\$24,120,000
	=====

## In Process Research & Development

The Company concluded as of the date of acquisition, the acquired intangible assets, consisting of developed core and product technologies had reached full development and that it was not the intention of the Company's management to utilize the assets in specific research and development activities as defined in SFAS No. 2 Accounting for Research & Development Costs. As a result, the Company determined there was no in-process research and development ("IPR& D") projects in place related to the technology acquired, nor any future research and development activities planned. Accordingly, there is no charge to operations during the year ended September 30, 2005 for IPR&D in connection with the acquisition of the assets.

## Transaction costs

The amount of the purchase price that could not be allocated to acquired identifiable intangible assets or IPR & D was \$14,689,100 and was charged to operations as a cost of the transaction during the year ended September 30, 2005.

F-28

## APPLIED DNA SCIENCES, INC (a development stage company) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2006

### NOTE B - ACQUISITION OF INTANGIBLE ASSETS (continued)

The identifiable intangible assets acquired and their carrying value at September 30, 2006 is:

Trade secrets and developed technologies (Weighted average life of 7 years)	\$ 9,430,900
Patents (Weighted average life of 5 years)	34,257
Total Amortized identifiable intangible	
assets-Gross carrying value:	\$ 9,465,157
Less:	
Accumulated Amortization	(1,702,683)
Impairment (See below)	(5,655,011)
	-----
Net:	\$ 2,107,463
Residual value:	\$ 0

During the year ended September 30, 2006, the Company management performed an evaluation of its intangible assets (intellectual property) for purposes of

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determining the implied fair value of the assets at September 30, 2006. The test indicated that the recorded remaining book value of its intellectual property exceeded its fair value, as determined by discounted cash flows. As a result, upon completion of the assessment, management recorded a non-cash impairment charge of \$5,655,011, net of tax, or \$0.05 per share during the year ended September 30, 2006 to reduce the carrying value of the patents to \$2,091,800. Considerable management judgment is necessary to estimate the fair value. Accordingly, actual results could vary significantly from management's estimates.

Total amortization expense charged to operations for the year ended September 30, 2006 and 2005 were \$1,354,101 and \$346,825 respectively.

Estimated amortization expense as of September 30, 2006 is as follows:

2007	\$ 370,643
2008	370,643
2009	365,753
2010	363,792
2011 and after	636,632
	-----
Total	\$ 2,107,463
	=====

### NOTE C - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at September 30, 2006 are as follows:

Accounts payable	\$ 334,675
Accrued consulting fees	30,000
Accrued payable taxes	-
Accrued interest payable	221,390
Other accrued expenses	4,973,967
	-----
Total	\$ 5,560,032
	=====

F-29

### APPLIED DNA SCIENCES, INC (a development stage company) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2006

### NOTE D - PRIVATE PLACEMENT OF CONVERTIBLE NOTES

Convertible notes payable as of September 30, 2006 are as follows:

September 30, 2006

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10% Secured Convertible Notes Payable dated March 8, 2006, net of unamortized debt discount of \$537,010 (see below)	\$ 962,990
10% Secured Convertible Notes Payable dated May 2, 2006, net of unamortized debt discount of \$303,958 (see below)	696,042
10% Secured Convertible Notes Payable dated June 15, 2006, net of unamortized debt discount of \$847,261 (see below)	2,102,739
Subtotal	3,761,771
Less, current	\$(3,761,771)
Convertible notes payable -long-term	--
	=====

## 10% Secured Convertible Promissory Notes dated March 8, 2006

On March 8, 2006, in connection with a private placement, the Company issued 10% Secured Convertible Promissory Notes in the aggregate principal amount of \$1,500,000 (the "Serial Notes") and warrants to purchase 3,000,000 shares of the Company's common stock to accredited investors. The Serial Notes bear interest at 10%, mature on September 7, 2007 and are convertible into the Company's common stock, at the holder's option, at fifty cents (\$0.50) per share during the period from the date of issuance (March 8, 2006) through March 7, 2007. Should the holder of the Serial Note elect not to convert to the Company's common stock on or before March 7, 2007, the outstanding principal, along with accrued and unpaid interest automatically converts to the Company's common stock at an amount equal to 80% of the average bid price of the Company's common stock on the Over-The-Counter Bulletin Board for a period equal to ten (10) days prior to conversion on the maturity date of September 7, 2007. The full principal amount of the Serial Notes is due upon a default under the terms of the Note Agreement. In addition, the Company granted the Investors a security interest in all of its assets (see Note B). The Company agreed to file a registration statement with the SEC to effect the registration of the shares of its common stock underlying the Serial Notes and the warrants within 30 days of the effective date of the Company's pending Registration Statement (SEC File 333 - 122848) being declared effective. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 180 days after its filing. If the Registration Statement is not filed and declared effective as described above, the Company will be required to pay liquidated damages in the form of cash to the holders of the Serial Notes, in an amount equal to 2% of the unpaid principal balance per month if the above deadlines are not met. In the event of a default on the Serial Notes, the Serial Notes will bear interest at twelve percent (12%) per annum until paid.

The warrants are exercisable until five years from March 8, 2006 until March 7, 2011 at a price of \$0.50 per share. The Company has the right, but not the obligation, to call these warrants for \$1.25 per share at the earlier of (i) one year from issuance or (ii) the date that shares of common stock issuable upon conversion of the Serial Notes and exercise of the warrants are registered for resale and the Company's common stock trades at or above \$1.25 per share for twenty (20) consecutive trading days. The Notes include certain features that are considered embedded derivative financial instruments, such as a variety of conversion options, a variable interest rate feature, events of default and a variable liquidated damages clause.

The initial relative fair value assigned to the embedded derivatives was \$346,500.



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In conjunction with the Notes, the Company issued warrants to purchase 3,000,000 shares of common stock. The accounting treatment of the derivatives and warrants requires that the Company record the warrants at their fair values as of the inception date of the debt issuance, which totaled \$512,100.

F-30

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

NOTE D - PRIVATE PLACEMENT OF CONVERTIBLE NOTES (continued)

The Company recorded the fair value of the derivatives (\$346,500) and warrants (\$ 512,100) to debt discount, aggregating \$858,600, which will be amortized to interest expense over the term of the Notes. Amortization of \$321,590 was recorded for the year ended September 30, 2006.

The market price of the Company's common stock significantly impacts the extent to which the Company may be required or may be permitted to convert the Serial Notes into shares of the Company's common stock. The lower the market price of the Company's common stock at the due date of September 7, 2007, the more shares the Company will need to issue to convert the principal and interest payments then due on the Notes.

10% Secured Convertible Promissory Notes dated May 2, 2006

On May 2, 2006, in connection with a private placement, the Company issued 10% Secured Convertible Promissory Notes in the aggregate principal amount of \$1,000,000 (the "Serial Notes") and warrants to purchase 2,000,000 shares of the Company's common stock to accredited investors. The Serial Notes bear interest at 10%, mature on August 2, 2007 and are convertible into the Company's common stock, at the holder's option, at fifty cents (\$.50) per share during the period from the date of issuance (May 2, 2006) through May 2, 2007. Should the holder of the Serial Note elect not to convert to the Company's common stock on or before May 2, 2007, the outstanding principal, along with accrued and unpaid interest automatically converts to the Company's common stock at an amount equal to 80% of the average bid price of the Company's common stock on the Over-The-Counter Bulletin Board for a period equal to ten (10) days prior to conversion on the maturity date of May 2, 2007. The full principal amount of the Serial Notes is due upon a default under the terms of the Note Agreement. In addition, the Company granted the Investors a security interest in all of its assets (see Note B). The Company agreed to file a registration statement with the SEC to effect the registration of the shares of its common stock underlying the Serial Notes and the warrants within 30 days of the effective date of the Company's pending Registration Statement (SEC File 333 - 122848) being declared effective. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 180 days after its filing. In the event of a default on the Serial Notes, the Serial Notes will bear interest at twelve percent (12%) per annum until paid.

The warrants are exercisable until four years from May 2, 2007 until May 2, 2011 at a price of \$0.50 per share. The Company has the right, but not the obligation, to call these warrants for \$0.001 per share at the earlier of (i) one year from issuance and (ii) the date that shares of common stock issuable upon conversion of the Serial Notes and exercise of the warrants are registered for resale and the Company's common stock trades at and above \$1.00 per share for twenty (20) consecutive trading days. The Notes include certain features

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that are considered embedded derivative financial instruments, such as a variety of conversion options, a variable interest rate feature, events of default and a variable liquidated damages clause.

The initial relative fair value assigned to the embedded derivatives was \$82,358.

In conjunction with the Notes, the Company issued warrants to purchase 2,000,000 shares of common stock. The accounting treatment of the derivatives and warrants requires that the Company record the warrants at their fair values as of the inception date of the debt issuance, which totaled \$373,600.

The Company recorded the fair value of the derivatives (\$82,358) and warrants (\$373,600) to debt discount, aggregating \$455,958, which will be amortized to interest expense over the term of the Notes. Amortization of \$152,000 was recorded for the year ended September 30, 2006.

The market price of the Company's common stock significantly impacts the extent to which the Company may be required or may be permitted to convert the Serial Notes into shares of the Company's common stock. The lower the market price of the Company's common stock at the due date of September 7, 2007, the more shares the Company will need to issue to convert the principal and interest payments then due on the Notes.

F-31

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

NOTE D - PRIVATE PLACEMENT OF CONVERTIBLE NOTES (continued)

10% Secured Convertible Promissory Notes dated June 15, 2006

On June 15, 2006, in connection with a private placement, the Company issued 10% Secured Convertible Promissory Notes in the aggregate principal amount of \$2,950,000 (the "Serial Notes") and warrants to purchase 5,900,000 shares of the Company's common stock to accredited investors. The Serial Notes bear interest at 10%, mature on August 2, 2007 and are convertible into the Company's common stock, at the holder's option, at fifty cents (\$.50) per share during the period from the one years from the date of issuance (June 15, 2006) through June 15, 2007. Should the holder of the Serial Note elect not to convert to the Company's common stock on or before June 15, 2007, the outstanding principal, along with accrued and unpaid interest automatically converts to the Company's common stock at an amount equal to 80% of the average bid price of the Company's common stock on the Over-The-Counter Bulletin Board for a period equal to ten (10) days prior to conversion on the maturity date of June 15, 2007. The full principal amount of the Serial Notes is due upon a default under the terms of the Note Agreement. In addition, the Company granted the Investors a security interest in all of its assets (see Note B). The Company agreed to file a registration statement with the SEC to effect the registration of the shares of its common stock underlying the Serial Notes and the warrants within 30 days of the effective date of the Company's pending Registration Statement (SEC File 333 - 122848) being declared effective. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 180 days after its filing. In the event of a default on the Serial Notes, the Serial Notes will bear interest at twelve percent (12%) per annum until paid.

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The warrants are exercisable until four years from June 15, 2007 until June 15, 2011 at a price of \$0.50 per share. The Company has the right, but not the obligation, to call these warrants for \$0.001 per share at the earlier of (i) one year from issuance and (ii) the date that shares of common stock issuable upon conversion of the Serial Notes and exercise of the warrants are registered for resale and the Company's common stock trades at and above \$1.00 per share for twenty (20) consecutive trading days. The Notes include certain features that are considered embedded derivative financial instruments, such as a variety of conversion options, a variable interest rate feature, events of default and a variable liquidated damages clause.

The initial relative fair value assigned to the embedded derivatives was \$175,321.

In conjunction with the Notes, the Company issued warrants to purchase 5,900,000 shares of common stock. The accounting treatment of the derivatives and warrants requires that the Company record the warrants at their fair values as of the inception date of the debt issuance, which totaled \$929,840.

The Company recorded the fair value of the derivatives (\$175,321) and warrants (\$929,840) to debt discount, aggregating \$1,105,161, which will be amortized to interest expense over the term of the Notes. Amortization of \$257,900 was recorded for the year ended September 30, 2006.

The market price of the Company's common stock significantly impacts the extent to which the Company may be required or may be permitted to convert the Serial Notes into shares of the Company's common stock. The lower the market price of the Company's common stock at the due date of September 7, 2007, the more shares the Company will need to issue to convert the principal and interest payments then due on the Notes.

### \$ 1,675,000 Convertible Notes

Convertible notes payable ("Bridge Unit Offering") in quarterly installments of interest only at 10% per annum, secured by all assets of the Company and due on the earlier of the 9 month anniversary date of the initial closing of the offering or the completion of any equity financing of \$3,000,000 or more; the Company, at its sole discretion may prepay principal at any time without penalty. The Bridge Unit Offering Notes unpaid principal along with accrued and unpaid interest were converted to an aggregate of 4,988,051 shares of the Company's common shares at a price equal to approximately \$0.33 per share during the quarter ended March 31, 2005.

F-32

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

### NOTE D - PRIVATE PLACEMENT OF CONVERTIBLE NOTES (continued)

### \$ 1,465,000 Convertible Notes

Beginning in December, 2004, the Company sold a 10% convertible debenture in the aggregate amount of \$ 1,465,000 in a private placement and exempt offerings to sophisticated investors, net of costs and fees.

The Convertible Note's terms called for the debt to automatically convert at

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\$0.50 per share upon the filing a of a registration statement with the Securities and Exchange Commission.

The Company filed the registration statement on February 15, 2005 and the Convertible Notes were converted to an aggregate of 2,930,000 shares of the Company's common stock in February 2005.

As additional consideration for the purchase of the Convertible Notes, the Company granted to the holders warrants entitling it to purchase 2,930,000 common shares of the Company's common stock at the price of \$0.75 per share. These warrants were issued in February, 2005 and lapse if unexercised by February, 2010. A registration rights agreement was executed in December 2004 and consummated in February, 2005 requiring the Company to register the shares of its common stock underlying the Convertible Notes and warrants so as to permit the public resale thereof. The registration rights agreement provided for the payment of liquidated damages of 3.5% of the aggregate Convertible Note financing per month if the stipulated registration deadlines were not met. The liquidated damages, which approximate \$ 51,275 per month, may be paid, at the Company's option, in cash or unregistered shares of the Company's common stock.

In accordance with Emerging Issues Task Force Issue 98-5, Accounting for Convertible Securities with a Beneficial Conversion Features or Contingently Adjustable Conversion Ratios ("EITF 98-5"), the Company recognized an embedded beneficial conversion feature present in the Convertible Notes. The Company allocated a portion of the proceeds equal to the intrinsic value of that feature to additional paid-in capital. The Company recognized and measured an aggregate of \$1,465,000 of the proceeds, which is equal to the intrinsic value of the embedded beneficial conversion feature, to additional paid-in capital and a discount against the Convertible Notes. Since the Convertible Notes were converted to the Company's common stock in February 2005, the debt discount attributed to the beneficial conversion feature of \$ 1,465,000 was charged to interest expense in its entirety during the year ended September 30, 2005.

In conjunction with raising capital through the issuance of Convertible Notes, the Company has issued a warrant in February, 2005 that has registration rights for the underlying shares. As the contract must be settled by the delivery of registered shares and the delivery of the registered shares is not controlled by the Company, pursuant to EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the net value of the warrants at the date of issuance was recorded as a warrant liability on the balance sheet \$3,845,039 and charged to operations as interest expense. Upon the registration statement being declared effective, the fair value of the warrant on that date will be reclassified to equity. The Company initially valued the warrants using the Black-Scholes pricing model with the following assumptions: (1) dividend yield of 0%; (2) expected volatility of 148.66%, (3) risk-free interest rate of 3.21%, and (4) expected life of 3 years.

In connection with the placement of the \$1,465,000 of convertible notes as described above, the Company agreed to registered shares of the Company's common stock underlying certain previously issued and outstanding warrants that were not subject to a registration rights agreement at the time the warrants were issued. These warrants consist of following:

105,464 warrants entitling the holder to purchase 105,464 shares of the Company's common stock at the price of \$0.10 per share. These warrants were issued in July, 2004 and lapse if unexercised by July, 2009.

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APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

### NOTE D - PRIVATE PLACEMENT OF CONVERTIBLE NOTES (continued)

1,602,500 warrants entitling the holder to purchase 1,602,500 shares of the Company's common stock at the price of \$0.60 per share. These warrants were issued in October, 2003 and lapse if unexercised by October, 2008.

As a result, the Company is required to classify the warrants as derivative liabilities and mark them to market at each reporting date. The fair value of the warrants that were subject to registration reclassified as liabilities from additional paid in capital at February 2005 totaled \$3,108,851. Upon the registration statement being declared effective, the fair value of the warrants on that date will be reclassified to equity. The Company initially valued the warrants using the Black-Scholes pricing model with the following assumptions: (1) dividend yield of 0%; (2) expected volatility of 148.66%, (3) risk-free interest rate of 3.21%, and (4) expected life of 3 years.

#### \$ 7,371,000 Convertible Notes

In January and February, 2005, the Company sold a 10% convertible debenture in the aggregate amount of \$7,371,000 in a private placement and exempt offerings to sophisticated investors, net of costs and fees.

The Convertible Note's terms called for the debt to automatically convert at \$0.50 per share upon the filing of a registration statement with the Securities and Exchange Commission.

The Company filed the registration statement on February 15, 2005 and the Convertible Notes were converted to an aggregate of 14,742,000 shares of the Company's common stock.

As additional consideration for the purchase of the Convertible Notes, the Company granted to the holders warrants entitling it to purchase 14,742,000 common shares of the Company's common stock at the price of \$0.75 per share. These warrants lapse if unexercised by February, 2010. A registration rights agreement was executed and consummated in January, 2005 requiring the Company to register the shares of its common stock underlying the Convertible Notes and warrants so as to permit the public resale thereof. The registration rights agreement provided for the payment of liquidated damages of 3.5% of the aggregate Convertible Note financing per month if the stipulated registration deadlines were not met. The liquidated damages, which approximate \$ 257,985 per month, may be paid, at the Company's option, in cash or unregistered shares of the Company's common stock.

In accordance with Emerging Issues Task Force Issue 98-5, Accounting for Convertible Securities with a Beneficial Conversion Features or Contingently Adjustable Conversion Ratios ("EITF 98-5"), the Company recognized an embedded beneficial conversion feature present in the Convertible Notes. The Company allocated a portion of the proceeds equal to the intrinsic value of that feature to additional paid-in capital. The Company recognized and measured an aggregate of \$ 7,731,000 of the proceeds, which is equal to the intrinsic value of the embedded beneficial conversion feature, to additional paid-in capital and a discount against the Convertible Notes. Since the Convertible Notes were converted to the Company's common stock in February 2005, the debt discount attributed to the beneficial conversion feature of \$ 7,371,000 was charged to interest expense in its entirety during the year ended September 30, 2005.

In conjunction with raising capital through the issuance of Convertible Notes,

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the Company has issued warrants that have registration rights for the underlying shares. As the contract must be settled by the delivery of registered shares and the delivery of the registered shares is not controlled by the Company, pursuant to EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the net value of the warrants at the date of issuance was recorded as a warrant liability on the balance sheet \$19,303,175 and charged to operations as interest expense. Upon the registration statement being declared effective, the fair value of the warrant on that date will be reclassified to equity. The Company initially valued the warrants using the Black-Scholes pricing model with the following assumptions: (1) dividend yield of 0%; (2) expected volatility of 152.59%, (3) risk-free interest rate of 3.67%, and (4) expected life of 5 years.

F-34

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

### NOTE D - PRIVATE PLACEMENT OF CONVERTIBLE NOTES (continued)

#### Revaluation of Warrant Liability

In accordance with SFAS 133 "Accounting for Derivative Instruments and Hedging Activities", the Company revalued the warrants issued subject to registration rights as of September 30, 2006 using the Black-Scholes option pricing model (see Note G). Assumptions were as follows: risk free rate- 4.57 to 4.90%, a volatility of 127.02% and a deemed fair value of common stock of \$0.10, which was the closing price of the Company's common stock on September 30, 2006. The difference of \$16,844,837 between the fair value of the warrants as of September 30, 2006 and the previous valuation as of September 2005 has been recorded as a gain on revaluation of warrant liability, and included in the accompanying consolidated financial statements.

### NOTE E - RELATED PARTY TRANSACTIONS

At September 30, 2006, notes payable are as follows:

Note payable, unsecured, related party, payable from August 1, 2005, right to convert to restricted stock in lieu of cash, rate of interest 2%, 160,000 shares prior to October 31, 2005 or 180,000 shares after that date. Since September 2005, the Company has made no payments and is now in default. (See Note N)	\$	410
		-----

Less: current portion		(410)
		-----

Note payable - long-term	\$	
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In February, 2005 the Company issued 1,500,000 shares of its restricted common stock to a Company officer and Director in exchange for \$600,000 of previously incurred debt. The debt was in the form of a promissory note.

The Company valued the shares at \$1.31 per share for a total of \$1,965,000,

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which represents the fair value of the common stock on the date of the exchange. The difference between the fair value of the common stock of \$1,965,000 and the face value of the debt of \$600,000 or \$1,365,000 has been charged to current period interest expense.

On July 15, 2005, the Company entered into a consulting agreement with Timpix International Limited ("Timpix") for the consulting services of three former Biowell employees, Drs. Jun-Jei Sheu, Ben Liang and Johnson Chen. The consulting agreement is for the shorter of two years, or until all of the consultants have obtained a visa to work in the United States and execute employment agreements with the Company. The consulting agreement shall automatically renew for one year periods until terminated. Pursuant to the consulting agreement, the Company is obligated to pay \$47,000 per month, which is apportioned at \$20,000 per month for Mr. Sheu, \$15,000 per month for Mr. Liang and \$12,000 per month for Mr. Chen. In the event that either of Messrs. Sheu, Liang or Chen becomes employed by us, the monthly consulting fee shall be reduced accordingly. The Company has negotiated an agreement to restructure the Consulting Agreement, whereby, fees owed to Timpix from July 2005 through September 2006 will be waived. (See Note N)

F-35

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

NOTE E - RELATED PARTY TRANSACTIONS (continued)

In July 2005, the Company entered into a license agreement with Biowell, whereby the Company granted Biowell an exclusive license to sell, market, and sub-license the Company's products in selected Asian countries. The exclusive license for such selected territories is for an initial period of until December 31, 2010, and if Biowell meets its performance goals, the license agreement will extend for an additional five year term. The license agreement gives Biowell the initial rights to future anti-fraud biotechnologies developed by the Company and also new applications for the existing technology that may be developed for the marketplace as long as the license agreement remains in effect. In the event that Biowell shall sub-license the products within its territories, Biowell shall pay the Company 50% of all fees, payments or consideration or any kind received in connection with the grant of the sublicense. Biowell is required to pay a royalty of 10% on all net sales made and is required to meet certain minimum annual net sales in its various territories. Cumulative royalties earned from the period July 2005 through September 30, 2006 totaled \$36,851 and is included in other income. Net amounts owed to the Company by Biowell in connection with the royalty agreement as of September 30, 2006 are \$ 8,419.

On March 29, 2006, and April 13, 2006, the Company borrowed \$200,000 in the aggregate, at a rate of 7.5% per annum, from BioCogent, Ltd., ("BioCogent"), an entity controlled by the Company's President and Chief Executive Officer. These loans were due and payable upon the earlier to occur of (1) the close of business on June 30, 2006, or (2) the closing of the issuance and sale by the Company of its securities for gross proceeds of at least \$250,000. These loans were paid in full as of September 30, 2006.

The Company's current and former officers and shareholders have advanced funds to the Company for travel related and working capital purposes. No formal repayment terms or arrangements exist. There were no advances due at September 30, 2006. \$-0-.

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During the year ended September 30, 2006, \$18,900 of the Company's sales of products, or 100% of total sales, were made to Dr. Suwelack Skin & Health Care AG ("Dr. Suwelack"), a German corporation. James A. Hayward, a director and Chief Executive Officer of the Company, is Dr. Suwelack's President and serves on its board of directors. As of September 30, 2006, amounts owed to the Company by Dr. Suwelack are \$9,630, which amount is included in accounts receivable.

### NOTE F - CAPITAL STOCK

The Company is authorized to issue 10,000,000 shares of preferred stock with a \$0.001 par value per share. The Company is authorized to issue 250,000,000 shares of common stock, with a \$0.001 par value per share as the result of a shareholder meeting conducted on February 14, 2005. Prior to the February 14, 2005 share increase and par value change, the Company had 100,000,000 authorized shares with a par value of \$0.50. In February 2005, the Company passed a resolution authorizing change in the par value per common shares from \$0.50 per share to \$0.001 per share.

The preferred stock is convertible at the option of the holder into common stock at the rate of twenty-five (25) shares of common for every one share of preferred at the option of the holder.

#### Preferred and Common Stock Transactions During the Year Ended September 30, 2003

During the period September 16, 2002 through September 30, 2003, the Company issued 100,000 shares of common stock in exchange for reimbursement of services provided by the founders of the Company. The Company valued the shares issued at approximately \$1,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In October, 2002, the Company issued 10,178,352 shares of common stock in exchange for the previously issued 100,000 shares to the Company's founders in connection with the merger with Prohealth Medical Technologies, Inc.

In October, 2002 the Company canceled 100,000 shares of common stock issued to the Company's founders.

F-36

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

### NOTE F - CAPITAL STOCK (continued)

During the fiscal year ended September 30, 2003, the Company issued 2,369,130 shares of common stock, net of cancellation of 860,000 shares in exchange for consulting services. The Company valued the shares issued at \$2,191,227, net of cancellation of \$60,008, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In November 2003, the Company issued 876,000 shares of common stock in exchange for subscription at approximately \$ 0.065 per share.

In January 2003, the Company issued 1,500,000 shares of common stock in exchange for a licensing agreement (see Note I). The Company valued the shares issued at



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approximately \$0.065 per share, which represents the fair value of the license received which did not differ materially from the value of the stock issued. The Company charged the cost of the license to operations.

In March 2003, the Company issued 10,140,000 shares of common stock to Company's founders in exchange for services. In accordance with EITF 96-18 the measurement date to determine fair value was in September 2002. This was the date at which a commitment for performance by the counter party to earn the equity instrument was reached. The Company valued the shares issued at approximately \$0.0001 per share, which presents the fair value of the services received which did not differ materially from the value of the stock issued.

In connection with the Company's acquisition of ProHealth, the controlling owner of ProHealth granted the Company an option to acquire up to 8,500,000 shares of the Company's common stock in exchange for \$100,000 (see Note C). The option expires on December 10, 2004. On June 30, 2003, the Company exercised its option and acquired 7,500,000 common shares under this agreement in exchange for an \$88,500 convertible promissory note payable to the former controlling owner. The Company has an option through December 10, 2004 to acquire the remaining 1,000,000 shares from the former controlling owner in exchange for \$11,500. On June 30, 2003, the Company retired the 7,500,000 shares common acquired pursuant to the option agreement.

In September 2003, the Company issued 19,200 shares of common stock for cash previously subscribed at \$2.50 per share.

During the fiscal year ended September 30, 2003, the Company issued 154,000 shares of common stock in exchange for previously issued options to purchase the Company's common stock at \$1.00 per share.

During the fiscal year ended September 30, 2003, the Company issued 74,400 shares of common stock in exchange for cash at approximately \$0.89 per share.

### Preferred and Common Stock Transactions During the Year Ended September 30, 2004

In October 2003, the Company issued 15,000 shares of convertible preferred stock in exchange for services. The Company valued the shares issued at the \$15 par value and recorded the value for services when the shares were converted into common shares as identified below.

During the fiscal year ended September 30, 2004, the Company issued 5,149,472 shares of common stock, net of cancellation of 155,000 shares, in exchange for consulting services. The Company valued the shares issued at \$8,787,315, net of cancellation of \$408,575, which represents the fair value of the services received which did not differ materially from the value of the stock issued

During the fiscal year ended September 30, 2004, the Company issued 340,500 shares of common stock for shares previously subscribed at approximately \$2.04 per share.

In March 2004, the Company issued 55,000 of common stock for options exercised at \$1.00 per share.

F-37

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### NOTE F - CAPITAL STOCK (continued)

During the fiscal year ended September 30 2004, the Company converted 15,000 preferred shares into 375,000 shares of common stock at \$1.47 per share in exchange for employee services valued at \$549,750.

In June 2004, the Company sold 250,000 shares of common stock at \$1.00 per share for total proceeds of \$250,000 pursuant to private placement.

In September 2004, the Company issued 60,000 convertible preferred shares at \$25.00, in exchange for consulting services valued at \$1,500,000.

#### Preferred and Common Stock Transactions During the Year Ended September 30, 2005

During the fiscal year ended September 30, 2005, the Company issued 11,040,647 shares of common stock, net of cancellation of 2,329,600 shares, in exchange for consulting and employee services. The Company valued the shares issued at \$13,008,371, net of cancellation of \$1,328,269, which represents the fair value of the services received which did not differ materially from the value of the stock issued

During the fiscal year ended September 30, 2005, the Company issued 1,500,000 shares of common stock for shares previously subscribed at approximately \$0.54 per share.

During the fiscal year ended September 30, 2005, the Company issued 267,500 shares of common stock for warrants and options exercised at approximately \$0.39 per share

During the fiscal year ended September 30, 2005, the Company retired \$1,796,057 of convertible notes payable for 5,363,809 shares of common stock. The Notes are convertible into shares of common stock at a price of \$0.34 per share.

During the fiscal year ended September 30, 2005, the Company issued 14,442,000 shares of common stock at \$0.50 per share pursuant to the exercise terms of notes payable. This issuance is considered exempt under Regulation D of the Securities Act of 1933 and Rule 506 promulgated thereunder.

In October 2004, the Company issued 500,000 shares of common stock in exchange for debt at \$0.50 per share.

In December 2004, the Company issued net 5,500,000 shares of common stock for default as per terms of notes payable for \$88,500. Out of total, 3,500,000 shares were retained in escrow on behalf of another party for future deferred compensation.

In February 2005, the Company in exchange for a related party note in the outstanding principal amount of \$600,000 and as settlement for certain claims related thereto issued 1,500,000 shares of common stock using a price of \$1.31 per share. (See note E)

In July 2005, the Company issued 36 million shares in exchange for intellectual property at approximately \$0.67 per share for a total of \$24,120,000. The value of the acquired intangible assets was established at \$9,430,900, with the balance of the purchase price, or \$14,689,100, charged to operations as a cost of the transaction. (See Note B)

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APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

### NOTE F - CAPITAL STOCK (continued)

In July 2005, the Company issued 8,550,000 shares of its common stock without restriction to employees in exchange for services rendered. The Company valued the shares issued at approximately \$0.48 per share for a total of \$3,840,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued. The Company is investigating the circumstances surrounding the issuance of the shares and the possible subsequent resale of certain of the shares on the open market and the possibility of violations of securities laws (see Note H).

In September 2005, the Company issued 814,158 penalty shares pursuant to the pending SB-2 registration terms. In connection with the 7,371,000 million convertible debt financing in the quarter ended March 30, 2005, the Company was obligated to complete a stock registration by July 2005. Since the registration was not effective by July 2005, the Company paid the required \$257,985 of liquidated damages in shares of Company stock accruing at the rate of 3.5% per month on the face value of the Notes for the month of July and August 2005. The Company valued the shares issued at approximately \$0.62 per share for a total of \$502,672.

In September 2005, the Company issued 391,224 penalty shares pursuant to the pending SB-2 registration terms. In connection with the 7,371,000 million convertible debt financing in the quarter ended March 30, 2005, the Company was obligated to complete a stock registration by July 2005. Since the registration was not effective by July 2005, the Company paid the required \$257,985 of liquidated damages in shares of Company stock accruing at the rate of 3.5% per month on the face value of the Notes for the month of September 2005. The Company valued the shares issued at approximately \$0.70 per share for a total of \$273,857.

### Preferred and Common Stock Transactions During the Year Ended September 30, 2006

In October 2005, the Company issued 100,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.75 per share for a total of \$75,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In October 2005, the Company cancelled 350,000 shares previously issued for services valued at \$210,000.

In October 2005, the Company issued 400,000 shares of common stock for services rendered at \$0.50 per share for a total of \$200,000 which represents the fair value of the services received which did not differ materially from value of the stock issued.

In December, 2005, the Company issued 40,000 shares of common stock subscribed for cash at \$0.50 per share for a total of \$20,000 pursuant to the terms of a subscription payable. This issuance is considered exempt under Regulation D of the Securities Act of 1933 and Rule 506 promulgated thereunder.

In December 2005, in connection with debt financing, the Company issued 5,500,000 warrants to purchase the Company's common stock at an exercise price of \$0.50 for five years. The fair value attributable to the warrants of \$563,750 was recorded as to current period operations with an offsetting adjustment to

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additional paid in capital.

In January, 2006, the Company cancelled 250,000 shares previously issued for services valued at \$150,000.

In January 2006, the Company issued 2,096,139 penalty shares pursuant to a registration rights agreement. In connection with the 7,371,000 million convertible debt financing in the quarter ended March 31, 2005, the Company was obligated to complete a stock registration by July 2005. Since the registration statement was not effective by July 2005, the Company paid the required \$257,985 of liquidated damages in shares of Company stock accruing at the rate of 3.5% per month on the face value of the Notes for the month of November and December 2005. The Company valued the shares issued at approximately \$0.25 per share for a total of \$515,973. The Company continues to accrue the penalties relating to the pending registration statement.

F-39

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

### NOTE F - CAPITAL STOCK (continued)

In February 2006, the Company issued 160,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.17 per share for a total of \$27,200, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In February 2006, the Company issued 3,800,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.16 per share for a total of \$608,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In March 2006, the Company cancelled 150,000 shares previously issued for services valued at \$120,000.

In July 2006, the Company issued 2,400,000 shares of common stock in exchange for consulting services. The Company valued the shares at \$0.20 per share for a total of \$480,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

### NOTE G - STOCK OPTIONS AND WARRANTS

#### Warrants

The Company issued options and warrants during the years ended September 30, 2006 and 2005 for consulting and employee services, fees in connection with obtaining financing and various other services. The following table summarizes the changes in options and warrants outstanding and the related prices for the shares of the Company's common stock issued to shareholders of the Company. These warrants were granted in lieu of cash compensation for services performed or financing expenses in connection with the sale of the Company's common stock.

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Exercise Prices	Number Outstanding	Warrants Outstanding Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable
-----	-----	-----	-----	-----
0.09	18,900,000	4.92	\$ 0.09	18,900,000
\$0.10	105,464	2.76	\$ 0.10	105,464
\$0.20	5,000	2.88	\$ 0.20	5,000
\$0.50	16,450,000	3.77	\$ 0.50	8,550,000
\$0.55	9,000,000	2.47	\$ 0.55	9,000,000
\$0.60	9,132,000	3.38	\$ 0.60	9,132,000
\$0.70	950,000	1.59	\$ 0.70	950,000
\$0.75	17,727,000	3.75	\$ 0.75	17,727,000
\$1.00	100,000	0.79	\$ 1.00	100,000
	-----			-----
	72,369,464			64,469,464

F-40

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

NOTE G - STOCK OPTIONS AND WARRANTS (continued)

Transactions involving warrants are summarized as follows:

	Number of Shares	Weighted Average Price Per Share
Balance, September 30, 2004	4,870,253	\$ 0.63
Granted	32,873,000	0.71
Exercised	(142,500)	0.34
Canceled or expired	(731,289)	0.65
Balance, September 30, 2005	36,869,464	\$ 0.67
Granted	35,250,000	0.29
Exercised	-	-
Canceled or expired	-	-
Balance, September 30, 2006	72,119,464	\$ 0.48

In July 2005, the Company consummated an agreement with Trilogy Capital Partners, Inc. and Joff Pollon ("Trilogy" and "Pollon") to provide marketing services to the Company for a term of one year, and terminable thereafter by either party upon 30 days prior written notice. In connection with the

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agreement, the Company agreed to pay Trilogy a monthly fee of \$12,500. The Company also issued to Trilogy and Pollon warrants to purchase an aggregate of 9,000,000 shares of common stock at \$0.55 per share, exercisable for a period of three years from issuance. As the contract must be settled by the delivery of registered shares and the delivery of the registered shares is not controlled by the Company, pursuant to EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the net value of the warrants at the date of issuance was recorded as a warrant liability of \$4,117,500 and charged to operations as consulting fees. Upon the registration statement being declared effective, the fair value of the warrants on that date will be reclassified to equity. The Company initially valued the warrants using the Black-Scholes pricing model with the following assumptions: (1) dividend yield of 0%; (2) expected volatility of 155.03%, (3) risk-free interest rate of 3.82%, and (4) expected life of 3 years.

In accordance with SFAS 133 "Accounting for Derivative Instruments and Hedging Activities", the Company revalued the warrants as of September 30, 2006 using the Black-Scholes option pricing model. The difference between the fair value of the warrants as of September 30, 2006 and the previous valuation as of July, 2005 has been recorded as a gain on revaluation of warrant liability, and included in the accompanying consolidated financial statements (see Note H)

In the year ended September 30, 2006, the Company granted 5,500,000 warrants to holders of the Company's \$550,000 notes payable with a \$0.50 exercise price and a five year life. For the first 36 months, the warrants include anti-dilution protection assuming no adjustment in the exercise price per share of common stock upon any reverse split of the Company's common stock.

In the year ended September 30, 2006, the Company granted 200,000 warrants as settlement to bridge financing with a \$0.70 exercise price and a three year life.

In the year ended September 30, 2006, the Company granted 10,900,000 warrants to holders of the Company's convertible notes (See Note D). The warrants have an exercise price of \$0.50 per with a five year life. Under certain conditions, as described in Note D, the Company as the option to redeem these warrants.

F-41

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

NOTE G - STOCK OPTIONS AND WARRANTS (continued)

During the year ended September 30, 2006, the Company granted 18,900,000 warrants to directors and advisors in exchange for services.. The estimated fair value of the compensatory warrants granted to the non-employees in exchange for services was determined using the Black-Scholes pricing model and the following assumptions: contractual term of 5 years, a risk free interest rate of 4.68%, a dividend yield of 0% and volatility of 123%. The amount of the expense charged to operations for compensatory warrants granted in exchange for services was \$1,426,725 for the year ended September 30, 2006.

The aggregate amounts of the expense charged to operations for compensatory warrants granted in exchange for services and financing expenses was \$1,426,725 and \$7,358,569, respectively, for the years ended September 30, 2006 and 2005.

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## Employee Stock Options

The following table summarizes the changes in options outstanding and the related prices for the shares of the Company's common stock issued to employees of the Company under a non-qualified employee stock option plan.

Options Outstanding			Options Exercisable		
Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$ 0.68	3,660,000	4.75	\$ 0.68	2,745,000	\$ 0.68
0.09	2,000,000	4.91	0.09	-	0.09
	-----			-----	
	5,660,000			2,745,000	0.47

Transactions involving stock options issued to employees are summarized as follows:

	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at October 1, 2004	-	\$ -
Granted	3,660,000	0.68
Exercised	-	-
Cancelled or expired	-	-
	-----	-----
Outstanding at September 30, 2005	3,660,000	\$ 0.68
Granted	2,000,000	0.09
Exercised	-	-
Canceled or expired	-	-
	-----	-----
Outstanding at September 30, 2006	5,660,000	\$ 0.47

Effective January, 2006, the Company adopted SFAS 123R and recognized compensation expense in its financial statements in fiscal 2006. Prior to the adoption of SFAS 123R, the Company accounted for its stock option plans according to Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation costs were recognized upon issuance or exercise of stock options for fiscal 2005.

SFAS No. 123, "Accounting for Stock-Based Compensation," required the disclosure of the estimated fair value of employee option grants and their impact on net income using option pricing models that are designed to estimate the value of options that, unlike employee stock options, can be traded at any time and are transferable. In addition to restrictions on trading, employee stock options

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(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

## NOTE G - STOCK OPTIONS AND WARRANTS (continued)

may include other restrictions such as vesting periods. Further, such models require the input of highly subjective assumptions, including the expected volatility of the stock price.

The weighted-average fair value of stock options granted to employees during the year ended September 30, 2006 and the weighted-average significant assumptions used to determine those fair values, using a Black-Scholes option pricing model are as follows:

F-43

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

## NOTE G - STOCK OPTIONS AND WARRANTS (continued)

2006

### Significant assumptions (weighted-average):

Risk-free interest rate at grant date	4.68%
Expected stock price volatility	123%
Expected dividend payout	-
Expected option life (in years)	5

If the Company recognized compensation cost for the non-qualified employee stock option plan in accordance with SFAS No. 123, the Company's pro forma net loss and net loss per share would have been \$ 68,515,869 and \$1.08, respectively, for the year ended September 30, 2005.

During the quarter ended March 31, 2005, the Company granted an aggregate of 300,000 stock options to directors that vested immediately. The exercise prices of the stock options granted were below the fair value of the Company's common stock at the grant date. Compensation expense of \$180,000 was charged to operations during the period ended March 30, 2005. In the quarter ended June 30, 2005, the Company canceled the unexercised 300,000 stock options and credited expense for the previously recorded \$180,000 in compensation.

In September 2006, the Company granted an aggregate of 2,000,000 stock options to employees vesting based on future service. The exercise price of the stock options granted was at the fair value of the Company's common stock at the grant date and expires five years from date of issuance.

At September 30, 2006, the exercise price of the 5,660,000 options was higher than the closing price of the Company's common stock on the NASD Over the Counter Bulletin Board (the "OTC BB") on September 30, 2006.

The intrinsic value of options outstanding and exercisable is the difference between the fair market value of the Company's common stock on the applicable



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date ("Measurement Value") and the exercise price of those options that had an exercise price that was less than the Measurement Value. The intrinsic value of options exercised is the difference between the fair market value of the Company's common stock on the date of exercise and the exercise price.

Information pertaining to the intrinsic value of options outstanding and exercisable at September 30, 2006 and 2005 is provided below:

	2006		2005
	-----		-----
Intrinsic value of options			
Outstanding	\$ -		\$ -
Exercisable	\$ -		\$ -

Information pertaining to the intrinsic value of options exercised and the fair value of options which became vested in each of the years ended September 30, 2006 and 2005 is provided below:

	2006	2005
	-----	-----
Intrinsic value of options exercised	\$ -	\$ -
Fair value of options vested	\$ 153,000	\$ 1,406,350

F-44

### APPLIED DNA SCIENCES, INC (a development stage company) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2006

#### NOTE H - DEBT DERIVATIVE AND WARRANT LIABILITY

In accordance with SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" and EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the Company accounted for identified embedded derivatives (See Note A) and warrants to purchase its common stock that provide for the payment of liquidated damages if the stipulated registration deadlines were not met as liabilities.

As of the date of this filing, the registration statement has not yet been declared effective by the SEC. The Company determined the fair value of the warrants using the Black-Scholes option pricing model. Assumptions regarding the life were one to five years, expected dividend yield of 0%, a risk free rate of 4.57 to 4.90%, and a volatility of 127.02%. The determined value of both the warrants and the underlying embedded derivatives as of September 30, 2006 was \$4,530,795. The net change in the fair value of the derivative and warrant liability values from September 30, 2005 has been recorded as a gain from change in debt derivative and warrant liabilities in the consolidated condensed

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statement of operations.

## NOTE I - INCOME TAXES

The Company has adopted Financial Accounting Standard No. 109 which requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statement or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between financial statements and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Temporary differences between taxable income reported for financial reporting purposes and income tax purposes are insignificant.

F-45

## APPLIED DNA SCIENCES, INC (a development stage company) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2006

### NOTE I - INCOME TAXES (continued)

At September 30, 2006, the Company has available for federal income tax purposes a net operating loss carryforward of approximately \$90,000,000, expiring in the year 2026, that may be used to offset future taxable income. The Company has provided a valuation reserve against the full amount of the net operating loss benefit, since in the opinion of management based upon the earnings history of the Company; it is more likely than not that the benefits will not be realized. Due to significant changes in the Company's ownership, the future use of its existing net operating losses may be limited. Components of deferred tax assets as of September 30, 2006 are as follows:

Non current:

Net operating loss carryforward	\$32,172,000
	-----
Valuation allowance	(32,172,000)
	-----
Net deferred tax asset	\$ --
	-----

### NOTE J-LOSS PER SHARE

The following table presents the computation of basic and diluted losses per share:

	For the Year Ended September 30, 2006	For the Year En September 30, 2
	-----	-----
Loss available for common shareholders	\$ (2,410,237)	\$ (67,1
	-----	-----

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Basic and fully diluted loss per share	\$ (0.02)	\$
	-----	-----
Weighted average common shares outstanding	116,911,022	63,

Net loss per share is based upon the weighted average of shares of common stock outstanding

### NOTE K- COMMITMENTS AND CONTINGENCIES

#### Operating Lease Commitments

The Company leases office space under operating lease in Stony Brook, New York for its corporate use from an entity controlled by significant former shareholder, expiring in November 2007. In November 2005, the Company vacated the Los Angeles facility to relocate to the new Stony Brook New York address (see Note K). Total lease rental expenses for the years ended on September 30, 2006 and 2005, was \$50,812 and \$138,661, respectively.

Commitments for minimum rentals under non-cancelable lease at September 30, 2006 are as follows:

Year ended September 30, 2007	\$ 50,000
2008	4,167
	-----
	\$ 54,167

#### Employment and Consulting Agreements

The Company has consulting agreements with outside contractors, certain of whom are also Company stockholders. The Agreements are generally month to month.

F-46

### APPLIED DNA SCIENCES, INC (a development stage company) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2006

#### NOTE K- COMMITMENTS AND CONTINGENCIES (continued)

On July 15, 2005, we entered into a consulting agreement with Timpix for the consulting services of three former Biowell employees, Drs. Jun-Jei Sheu, Ben Liang and Johnson Chen. The consulting agreement is for the shorter of two years, or until all of the consultants have obtained a visa to work in the United States and execute employment agreements with us. Such consulting agreement shall automatically renew for one year periods until terminated. Pursuant to the consulting agreement, we shall pay \$47,000 per month, which is apportioned at \$20,000 per month for Mr. Sheu, \$15,000 per month for Mr. Liang and \$12,000 per month for Mr. Chen. In the event that either of Messrs. Sheu, Liang or Chen becomes employed by us, the monthly consulting fee shall be reduced accordingly. The Company has negotiated an agreement to restructure the Consulting Agreement, whereby, fees owed to Timpix from July 2005 through September 2006 will be waived. (See Note N).

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### Litigation

On or about November 24, 2004, Oceanic Consulting, S.A. filed a complaint against the Company in the Superior Court of the State of New York. The Complaint alleges a breach of contract. The Company and the Plaintiff settled the dispute and the Company recorded the settlement amount as of September 30, 2006.

On or about January 10, 2005, Stern & Co. filed a complaint against the Company in the United States District Court for the Southern District of New York. The Complaint alleges a breach of contract. Subsequent to the date of the financial statements, the Company and the Plaintiff settled the dispute and the Company recorded the settlement amount as of September 30, 2006.

On April 29, 2005, Crystal Research Associates, LLC obtained a default judgment against us for \$13,000 in the Superior Court of New Jersey, Middlesex County. The Company settled this matter in May 2006.

On or about January 12, 2006, James Paul Brown, a former consultant to the Company filed a complaint against the Company in the Superior Court of the State of California. The Complaint alleges a breach of contract. Subsequent to the date of the financial statements, the Company and the Plaintiff settled the dispute and the Company recorded the settlement amount as of September 30, 2006.

In January 2006, a former employee of the Company filed a complaint alleging wrongful termination against the Company. The former employee is seeking \$230,000 in damages. The Company believes that it has meritorious defenses to the plaintiff's claims and intends to vigorously defend itself against the Plaintiff's claims. Management believes the ultimate outcome of this matter will not have a material adverse effect on the Company's consolidated financial position or results of operations.

On or about April 4, 2006, the Company filed a complaint against Paul Reep, Adrian Butash, John Barnett, Chanty Cheang, Jaime Cardona (former Company employees and officers), and Angela Wiggins (a former consultant to the Company) in the United States District Court for the Central District of California. The Company has asked the court to make a judicial determination that an agreement, which the Company did not authorize and which is the basis of previously disclosed litigation against the Company by Paul Reep, a former employee of the Company, and a new action filed by former employees of the Company as set forth in the subsequent paragraph, is invalid and unenforceable. This matter is in its early stages.

F-47

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

#### NOTE K- COMMITMENTS AND CONTINGENCIES (continued)

On or about April 17, 2006, former employees of the Company filed a complaint against the Company and certain of its current officers and Directors in Los Angeles County Superior Court. The Complaint alleges a breach of contract, violations of California Labor Code and wrongful termination and is seeking \$950,000 in specified damages, plus fees and costs. The complaint alleges a breach of contract. The Company believes that it has meritorious defenses to the plaintiff's claims and intends to vigorously defend itself against the

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Plaintiff's claims. Management believes the ultimate outcome of this matter will not have a material adverse effect on the Company's consolidated financial position or results of operations.

The Company is subject to other legal proceedings and claims, which arise in the ordinary course of its business. Although occasional adverse decisions or settlements may occur, the Company believes that the final disposition of such matters should not have a material adverse effect on its financial position, results of operations or liquidity.

### Registration of Company's Shares of Common Stock

Until the Company successfully completes its pending registration statement on SEC Form SB-2, the Company is subject to liquidated damages (see Notes D and H). In connection with the \$ 1,465,000 and \$ 7,371,000 million convertible debt financing during the quarters ended December 31, 2004 and March 31, 2005, respectively, the Company was obligated to deliver registered shares underlying the convertible notes and warrants by July 2005 (see Note C). Since the registration was not effective by July 2005, the Company has been accruing and charging to operations the stipulated liquidated damages in shares of Company stock accruing at the rate of 3.5% per month on the face value of the previously issued convertible notes. During the year ended September 30, 2006, the Company has paid and charged to operations penalties of \$773,958 in the form of unregistered shares of its common stock to the former note holders, and has accrued and charged to operations an additional \$4,025,356 representing unpaid penalties as of September 30, 2006.

### Matters Voluntarily Reported to the SEC and Securities Act Violations

We previously disclosed that we were investigating the circumstances surrounding certain issuances of 8,550,000 shares to employees and consultants in July 2005 (see Note G), and have engaged our new outside counsel to conduct this investigation. We have voluntarily reported our current findings from the investigation to the SEC, and we have agreed to provide the SEC with further information arising from the investigation. We believe that the issuance of 8,000,000 shares to employees in July 2005 was effectuated by both our former President and our former Chief Financial Officer/Chief Operating Officer without approval of the Board of Directors. These former officers received a total of 3,000,000 of these shares. In addition, it appears that the 8,000,000 shares issued in July 2005, as well as an additional 550,000 shares issued to employees and consultants in March, May and August 2005, were improperly issued without a restrictive legend stating that the shares could not be resold legally except in compliance with the Securities Act of 1933, as amended. Our investigation is continuing. The members of our management who effectuated the stock issuances that are being examined in the investigation no longer work for us. We believe that we may incur significant costs and expenses in continuing this investigation. In the event that any of the exemptions from registration with respect to the issuance of the Company's common stock under federal and applicable state securities laws were not available, the Company may be subject to claims by federal and state regulators for any such violations. In addition, if any purchaser of the Company's common stock were to prevail in a suit resulting from a violation of federal or applicable state securities laws, the Company could be liable to return the amount paid for such securities with interest thereon, less the amount of any income received thereon, upon tender of such securities, or for damages if the purchaser no longer owns the securities. As of the date of these financial statements, the Company is not aware of any alleged specific violation or the likelihood of any claim. There can be no assurance that litigation asserting such claims will not be initiated, or that the Company would prevail in any such litigation.

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APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

### NOTE K- COMMITMENTS AND CONTINGENCIES (continued)

The Company is unable to predict the extent of its ultimate liability with respect to any and all future securities matters. The costs and other effects of any future litigation, government investigations, legal and administrative cases and proceedings, settlements, judgments and investigations, claims and changes in this matter could have a material adverse effect on the Company's financial condition and operating results

### NOTE L - GOING CONCERN

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the accompanying financial statements during the period September 16, 2002 through September 30, 2006, the Company incurred a loss of \$92,334,791. These factors among others may indicate that the Company will be unable to continue as a going concern for a reasonable period of time.

The Company's existence is dependent upon management's ability to develop profitable operations. Management is devoting substantially all of its efforts to developing DNA embedded biotechnology security solutions in the United States and there can be no assurance that the Company's efforts will be successful. However, the planned principal operations have not commenced and no assurance can be given that management's actions will result in profitable operations or the resolution of its liquidity problems. The accompanying statements do not include any adjustments that might result should the Company be unable to continue as a going concern.

In order to improve the Company's liquidity, the Company's management is actively pursuing additional equity financing through discussions with investment bankers and private investors. There can be no assurance the Company will be successful in its effort to secure additional equity financing

### NOTE M - RESTATEMENT

The Company has restated its financial statements for the year ended September 30, 2005 and the period from September 16, 2002 (date of inception) through September 30, 2005 by filing an amended Form 10-KSB for the fiscal year ended September 30, 2005 to correct the following errors in the financial statements previously filed:

The Company did not recognize and record as a current period expense, warrants issued to consultants and non-employees having a fair value of \$7,358,568 (see Note F).

The Company erroneously recorded the value of shares issued to a former Director in exchange for previously incurred debt of \$1,365,000 (see Note E).

The Company did record the fair value of warrants issued to note holders and consultants having registration rights, \$23,148,214 in the aggregate, as a charge of operations and a liability in accordance with EITF 00-19 (see Note D).

The Company did not record the gain of \$16,700,991 on revaluation for the

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warrant liability as of September 30, 2005 (see Note D).

The results of the correction of these errors include:

- o Increase in the Company's reported net loss for the year ended September 30, 2005 by \$14,499,139 from \$52,610,380 to \$67,109,529.
- o Increase in the Company's current liabilities as of September 30, 2005 by \$384,651 from \$2,595,897 to \$2,980,548.

F-49

### APPLIED DNA SCIENCES, INC (a development stage company) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2006

#### NOTE M - RESTATEMENT (continued)

- o Increase in the Company's other liabilities, representing warranty liabilities, as of September 30, 2005 by \$13,673,574 from \$0 to \$13,673,574.

The result of the Consolidated Balance Sheet restatement is:

Increase in accounts payable and accrued expenses as of September 30, 2005 from \$2,185,468 to \$2,570,119, or \$384,651. The increase is a result of an error in recognizing, recording and accruing the fair value of warrants issued to non-employees and consultants of \$384,651 as of September 30, 2005.

Increase in warrant liability as of September 30, 2005 \$0 to \$13,673,574. The increase is a result of an error in accounting for the issuance of warrants subject to a registration rights agreement that provides for the payment of liquidated damages if the stipulated registration deadlines were not met (see Note D). In accordance with SFAS 133 "Accounting for Derivative Instruments and Hedging Activities," the Company revalued the warrants issued subject to registration rights as of September 30, 2005 (see Note G). The fair value of the warrants as of September 30, 2005 was \$13,673,574 and has been recorded as a warrant liability.

The following chart sets forth reconciliations of the Company's restatement of the Consolidated Balance Sheet as of September 30, 2005.

	September (As Restated)
ASSETS	
Current Assets:	
Cash	\$ 31,190
Accounts receivable and advances	12,429
	-----
Total current assets	43,619
Property, plant and equipment	12,750
Less: accumulated depreciation	(4,686)
	-----
	8,064

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Other Assets:	
Deposits	14,262
Intangible assets:	
Patents, net of accumulated amortization	22,493
Intellectual Property ,net of accumulated amortization	9,094,082
	-----
	9,130,837
	-----
	\$ 9,182,520
	=====
LIABILITIES AND DEFICIENCY IN STOCKHOLDERS' EQUITY	
Accounts payable and accrued liabilities	\$ 2,570,119
Note payable - Related Party	410,429
	-----
Total Current Liabilities	2,980,548
Warrant liability	13,673,574
Deficiency in Stockholders' Equity:	
Preferred Stock	6
Common Stock	112,230
Common stock subscribed	20,000
Additional Paid-In-Capital	82,320,715
Deficit Accumulated During Development Stage	(89,924,553)
Total (Deficiency) in Stockholders' Equity	(7,471,602)
	\$ 9,182,520

F-50

## APPLIED DNA SCIENCES, INC (a development stage company) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2006

### NOTE M - RESTATEMENT (continued)

The result of the Consolidated Statement of Losses restatement is:

Increase in selling, general and administrative expenses for the year ended September 30, 2005 from \$42,662,152 to \$50,714,015, or \$8,051,863. The increase is a result of an error in recognizing and recording the fair value of warrants issued to non-employees and consultants of \$6,402,264, an error in recognizing and recording the fair value of stock issued in settlement of debt of \$1,365,000 and an error in recognizing and recording additional compensation expense of \$284,599.

Increase in selling, general and administrative expenses for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$63,483,689 to \$71,535,604, or \$8,051,915. The increase is a result of an error in recognizing and recording the fair value of warrants issued to non-employees and consultants of \$6,402,264, an error in recognizing and recording the fair value of stock issued in settlement of debt of \$1,365,000 and an error in recognizing and recording of additional compensation expense of \$284,599.

Increase in the net gain on the revaluation of warrant liability for the year ended September 30, 2005 from \$0 to \$16,700,990, or \$16,700,990. The increase is a result of an error in accounting for the issuance of warrants subject to a registration rights agreement that provides for the payment of liquidated



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damages if the stipulated registration deadlines were not met (see Note D). In accordance with SFAS 133 "Accounting for Derivative Instruments and Hedging Activities," the Company revalued the warrants issued subject to registration rights as of September 30, 2005 (see Note G). The difference of \$16,700,991 between the fair value of the warrants as of September 30, 2005 and the previous valuation has been recorded as a gain on revaluation of warrant liability.

Increase in the net gain on the revaluation of warrant liability for the period September 16, 2002 (date of inception) through September 30, 2005 from \$0 to \$16,700,990, or \$16,700,990. The increase is a result of an error in accounting for the issuance of warrants subject to a registration rights agreement that provides for the payment of liquidated damages if the stipulated registration deadlines were not met (see Note D). In accordance with SFAS 133 "Accounting for Derivative Instruments and Hedging Activities," the Company revalued the warrants issued subject to registration rights as of September 30, 2005 (see Note G). The difference of \$16,700,991 between the fair value of the warrants as of September 30, 2005 and the previous valuation has been recorded as a gain on revaluation of warrant liability.

Increase in the interest expense for the year ended September 30, 2005 from \$8,958,046 to \$32,106,310, or \$23,148,264. The increase is a result of an error in recording and recognizing the recording of the initial valuation of warrants issued in conjunction with financing as a liability subject to registration rights.

Increase in the interest expense for the period September 16, 2002 (date of inception) through September 30, 2005 from \$10,736,232 to \$33,884,446, or \$23,148,214. The increase is a result of an error in recording and recognizing the initial valuation of warrants issued in conjunction with financing as a liability subject to registration rights.

The following chart sets forth reconciliations of the Company's restatement of the Consolidated Statement of Losses for the year ended September 30, 2005 as well as the period from September 16, 2002 (date of inception of development stage) through September 30, 2005.

F-51

### APPLIED DNA SCIENCES, INC (a development stage company) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2006

#### NOTE M - RESTATEMENT (continued)

	For the Year Ended September 30, 2005		For the Period September
	(As Restated)	(As Reported)	(date of Inception of Stage) through September
			(As Restated) (As Reported)
Operating Expenses:			
Selling general and administrative	\$ 50,714,017	\$ 42,662,152	\$ 71,535,604
Research and Development	638,873	638,873	877,408

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Depreciation and amortization	356,266	356,266	359,427
Total Operating Expenses	51,709,156	43,657,291	72,772,439
Operating Income (Loss)	(51,709,156)	(43,657,291)	(72,772,439)
Net gain (loss) in fair value of debt derivative and warrant liabilities	16,700,990	-	16,700,990
Other income (expense)	4,957	4,957	31,342
Interest income (expense)	(32,106,310)	(8,958,046)	(33,884,446)
Provision for income taxes	-	-	-
Net Income (Loss)	\$ (67,109,569)	\$ (52,610,380)	\$ (89,924,553)
Basic and diluted loss per common share	\$ (1.05)	\$ (0.82)	\$ (2.53)
Weighted average shares outstanding	63,517,009	63,517,009	35,590,871

The results of the restatement of the cash flow include:

## Cash Flows From Operating Activities:

Increase in net loss for the year ended September 30, 2005 from \$52,610,380 to \$67,109,519, or \$14,499,139, resulting from items listed above.

Increase in net loss for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$75,425,414 to \$89,924,553, or \$14,499,139 resulting from items listed above.

Increase in the non-cash value of warrants issued to consultants for services rendered for the year ended September 30, 2005 from \$956,304 to 7,358,568, or \$6,402,264. The increase is a result of an error in recognizing and recording the fair value of warrants to acquire our common stock issued to non-employees and consultants and charged to operations (see Note G).

F-52

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

NOTE M - RESTATEMENT (continued)

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Increase in the non-cash value of warrants issued to consultants for services rendered for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$956,304 to 7,358,568, or \$6,402,264. The increase is a result of an error in recognizing and recording the fair value of warrants to acquire our common stock issued to non-employees and consultants and charged to operations (see Note G).

Increase in the non-cash income attributable to re-pricing the warrant liability and debt derivatives for the year ended September 30, 2005 from \$0 to 16,700,991, or \$16,700,991. The increase is a result of an error in accounting for the issuance of warrants subject to a registration rights agreement that provides for the payment of liquidated damages if the stipulated registration deadlines were not met (see Note D). In accordance with SFAS 133 "Accounting for Derivative Instruments and Hedging Activities," the Company revalued the warrants issued subject to registration rights as of September 30, 2005 (see Note G).

Increase in the non-cash income attributable to re-pricing the warrant liability and debt derivatives for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$0 to \$16,700,991, or \$16,700,991. The increase is a result of an error in accounting for the issuance of warrants subject to a registration rights agreement that provides for the payment of liquidated damages if the stipulated registration deadlines were not met (see Note D). In accordance with SFAS 133 "Accounting for Derivative Instruments and Hedging Activities," the Company revalued the warrants issued subject to registration rights as of September 30, 2005 (see Note G).

Increase in the non-cash financing costs attributable to the issuance of warrants for the year ended September 30, 2005 from \$0 to \$23,148,214, or \$23,148,264. The increase is a result of an error in recording and recognizing the recording of the initial valuation of warrants issued in conjunction with financing as a liability subject to registration rights.

Increase in the non-cash financing costs attributable to the issuance of warrants for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$0 to \$23,148,214, or \$23,148,214. The increase is a result of an error in recording and recognizing the recording of the initial valuation of warrants issued in conjunction with financing as a liability subject to registration rights.

Increase in the non-cash cost of the fair value of common stock issued to a related party in excess of previously incurred debt for the year ended September 30, 2005 from \$0 to \$1,365,000, or \$1,365,000. The increase is a result of an error in recording and recognizing the fair value of stock issued in settlement of debt of \$1,365,000 to a former Director of the Company (See Note E).

Increase in the non-cash cost of the fair value of common stock issued to a related party in excess of previously incurred debt for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$0 to \$1,365,000, or \$1,365,000. The increase is a result of an error in recording and recognizing the fair value of stock issued in settlement of debt of \$1,365,000 to a former Director of the Company (See Note E). Increase in the non-cash cost of the fair value of common stock issued in exchange for services for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$27,202,860 to \$30,574,373, or \$3,371,513. The increase is a result of an error in recording and recognizing the fair value of stock issued for services by employees and non-employees and a reclassification common stock previously disclosed as stock issued pursuant to a employee stock option plan (See Note F).

Decrease in non-cash cost of common stock issued pursuant to an employee stock option plan for the year ended September 30, 2005 from \$3,960,000 to \$0, or

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\$3,960,000. The decrease is a result of reclassifying common stock issued pursuant to an employee stock option plan to common stock issued in exchange for services (See Note F).

F-53

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

NOTE M - RESTATEMENT (continued)

Decrease in non-cash cost of common stock issued pursuant to an employee stock option plan for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$3,960,000 to \$0, or \$3,960,000. The decrease is a result of reclassifying common stock issued pursuant to an employee stock option plan to common stock issued in exchange for services (See Note F).

Decrease in non-cash cost of common stock cancelled-previously issued for services rendered for the year ended September 30, 2005 from \$1,078,270 to \$578,270, or \$500,000. The decrease is a result of an error in recording and recognizing the fair value of stock issued for services by employees and non-employees that was subsequently cancelled (See Note F).

Decrease in non-cash cost of common stock cancelled-previously issued for services rendered for the period from September 16, 2002 (date of inception) through the year ended September 30, 2005 from \$1,363,845 to \$863,845, or \$500,000. The decrease is a result of an error in recording and recognizing the fair value of stock issued for services by employees and non-employees that was subsequently cancelled (See Note F). Decrease in cost of capital expenditures for the year ended September 30, 2005 from \$16,757 to \$0, or \$16,757.

The decrease is a result of reclassifying disbursement for the acquisition of equipment from operating activities to investing activities.

Increase in the amount of net proceeds from sale of equipment for the period from September 16, 2002 (date of inception) through the year ended September 30, 2005 from \$12,750 to \$0, or \$12,750. The increase is a result of reclassifying net proceeds received the sale of equipment from operating activities to investing activities.

Increase in change of accounts payable and accrued liabilities for the year ended September 30, 2005 from \$297,755 to \$663,748, or \$365,993. The increase is a result of an error in recognizing, recording and accruing the fair value of warrants issued to non-employees and consultants as of September 30, 2005. Increase in change of accounts payable and accrued liabilities for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$2,053,464 to \$2,419,457, or \$365,993. The increase is a result of an error in recognizing, recording and accruing the fair value of warrants issued to non-employees and consultants as of September 30, 2005.

Cash Flows From Investing Activities:

Increase in the cash provided by the sale of equipment for the year ended September 30, 2005 from \$0 to \$16,757, or \$16,757. The increase is a result of an error in properly classifying proceeds from the sale of equipment as an investing activity.

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Decrease in the cash used in capital expenditures for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$0 to \$12,750, or \$12,750. The decrease is a result of an error in properly classifying net disbursements in connection with acquiring equipment as an investing activity. Cash Flows From Financing Activities:

Increase in the cash used in repayment of previously incurred debt for the year ended September 30, 2005 from \$0 to \$24,854, or \$24,854. The increase is a result of an error in classifying repayment of debt as a financing activity.

Increase in the cash used in repayment of previously incurred debt for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$0 to \$24,854, or \$24,854. The increase is a result of an error in properly classifying repayment of debt as a financing activity.

F-54

### APPLIED DNA SCIENCES, INC (a development stage company) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2006

#### NOTE M - RESTATEMENT (continued)

Increase in proceeds from the sale of options to acquire the Company's common stock for the year ended September 30, 2005 from \$70,750 to \$102,750, or \$32,000. The increase is a result of an error in recognizing and recording \$32,000 of proceeds from the exercise of options as issuance of common stock (see Note F).

Increase in proceeds from the sale of options to acquire the Company's common stock for the period from September 16, 2002 (date of inception) through September 30, 2005 from \$311,750 to \$343,750, or \$32,000. The increase is a result of an error in recognizing and recording \$32,000 of proceeds from the exercise of options as issuance of common stock (see Note F).

Decrease in proceeds from subscription of common stock for the year ended September 30, 2005 from \$9,079,000 to \$0, or \$9,079,000. The decrease is a result of an error in recognizing and recording the proceeds from the issuance of convertible notes that were exchanged for the Company's common stock ( see Note D). Decrease in proceeds from subscription of common stock for the period September 16, 2002 (date of inception) through September 30, 2005 from \$9,204,000 to \$0, or \$9,204,000. The decrease is a result of an error in recognizing and recording the proceeds from the issuance of convertible notes that were exchanged for the Company's common stock ( see Note D).

The following chart sets forth reconciliations of the Company's restatement of the Consolidated Statement of Cash Flows for the year ended September 30, 2005 as well as the period September 16, 2002 (date of inception of development stage) through September 30, 2005.

For the Year Ended September 30, 2005		For the Period September 16, 2002 (date of Inception of Development Stage) through September 30, 2005	
(As Restated)	(As Reported)	(As Restated)	(As Reported)

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## Cash flows from Operating Activities:

Net income (loss)	\$ (67,109,519)	\$ (52,610,380)	\$ (89,924,553)	\$ (75,425,000)
Adjustment to reconcile net loss to net cash used in operating activities:				
Amortization and depreciation	350,107	350,107	353,268	353,268
Organization expenses	-	-	88,500	88,500
Preferred share issued in exchange for services	-	-	1,500,000	1,500,000
Warrants issued to consultants in exchange for services rendered	7,358,568	956,304	9,378,430	2,976,000
Income attributable to repricing of warrant and debt derivatives	(16,700,991)	-	(16,700,991)	-
Financing costs attributable to issuance of warrants	23,148,214	-	23,148,214	-

F-55

## APPLIED DNA SCIENCES, INC (a development stage company) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2006

### NOTE M - RESTATEMENT (continued)

	For the Year Ended September 30, 2005		For the Period September 16, 2002 (date of Inception of Development Stage) through September 30, 2005	
	(As Restated)	(As Reported)	(As Restated)	(As Reported)
Amortization of beneficial conversion feature-convertible notes	8,836,000	8,836,000	10,461,000	10,461,000
Amortization of capitalized financing costs	-	-	-	-
Amortization of debt discount attributable to convertible notes	-	-	-	-

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Fair value of common stock issued to related party in excess of previously incurred debt	1,365,000	-	1,365,000	
Common stock issued in exchange for services	18,176,641	14,805,128	30,574,373	27,202
Common stock issued to ESOP	-	3,960,000	-	3,960
Common stock exchanged for intellectual property in connection with costs of acquiring intangible assets	14,689,100	14,689,100	14,689,100	14,689
Common stock issued as penalty in connection with financing	776,529	776,529	776,529	776
Common stock canceled- previously issued for services rendered	(578,270)	(1,078,270)	(863,845)	(1,363
Change in assets and liabilities:				
Increase in accounts receivable	(12,429)	(12,429)	(12,429)	(12
Increase in prepaid assets and deposits	9,297	9,297	(14,262)	(14,
Decrease in other assets	-	-	(13,890)	(13,

F-56

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

NOTE M - RESTATEMENT (continued)

	For the Year Ended September 30, 2005		For the Period September 16 (date of Inception of Development Stage) through September 30
	(As Restated)	(As Reported)	(As Restated)
Capital expenditures	-	16,757	-
Increase (Decrease) in due related parties	(111,943)	(111,943)	40,753
Increase (decrease) in accounts payable and accrued liabilities	663,748	297,755	2,419,457

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Net cash used in operating activities	(9,139,948)	(9,116,045)	(12,735,346)
Cash flows from investing activities:			
Payments for patent filing	(4,347)	(4,347)	(25,698)
Capital expenditures (disposals)	16,757	-	(12,750)
Net cash used in investing activities	12,410	(4,347)	(38,448)
Cash Flows From Financing Activities:			
Proceeds from sale of common stock, net of costs	-	-	432,000
Proceeds from subscription of common stock	-	9,079,000	-
Proceeds from issuance of convertible notes	9,079,000	-	9,204,000
Proceeds from sale of options	102,750	70,750	343,750
Payment of debt	(24,854)	-	(24,854)
Proceeds from loans	-	-	2,750,000
Advances from (to) shareholders	-	-	100,088
Cash provided by financing activities	9,156,896	9,149,750	12,804,984
Net (decrease) increase in cash and cash equivalents	29,358	29,358	31,190
Cash, beginning of period	1,832	1,832	-
Cash and cash equivalents, end of period	\$ 31,190	\$ 31,190	\$ 31,190

F-57

APPLIED DNA SCIENCES, INC  
(a development stage company)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006

NOTE N - SUBSEQUENT EVENTS



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On November 28, 2006, the Company issued 180,000 shares of its common stock as settlement of the outstanding related party note payable of \$410,429 and related accrued interest of \$8,884 (See Note E)

On November 13, 2006, the Company restructured its consulting agreement with Timpix International Limited ("Timpix" for consulting services of three former Biowell employees. Drs Jun-Jei Sheu, Ben Liang and Johnson Chen. The restructured consulting agreement expires on July 15, 2007 or until all of the consultants have obtained a visa to work in the United States and execute employment agreements with the Company. The revised consulting agreement shall automatically renew for one year periods until terminated. Pursuant to the agreement, the Company is obligated to pay \$120,000, \$100,000 and \$80,000 per year pro-rated for each week, or part thereof, of time spent in the United States providing full time services for Drs Jun-Jei Sheu, Ben Liang and Johnson Chen, respectively. The Company is obligated to provide a corporate house available for the Consultants while working in the United States. All previous fees incurred through November 13, 2006 have been waived. (See Notes E and K)

F-58

### ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

There have been no disagreements between the Company and its accountants as to matters which require disclosure.

#### Item 8A -- Controls and Procedures

a) Evaluation of Disclosure Controls and Procedures. As of September 30, 2006, the Company's management carried out an evaluation, under the supervision of the Company's Chief Executive Officer (who is its principal executive officer and principal financial officer), of the effectiveness of the design and operation of the Company's system of disclosure controls and procedures pursuant to the Securities and Exchange Act and Rules 13a-15(e) and 15d-15(e) thereunder. Based upon that evaluation, the Company's Chief Executive Officer concluded that the Company's disclosure controls and procedures were not effective, as of the date of their evaluation, for the purposes of recording, processing, summarizing and timely reporting material information required to be disclosed in reports filed by the Company under the Securities Exchange Act of 1934.

As previously disclosed in our Current Reports on Form 8-K, filed on May 18, 2006 and October 2, 2006, and Note M to our accompanying consolidated financial statements, as a result of comments raised by the SEC, we determined that accounting errors were made in connection with

- o accounting for and disclosing the fair value of warrants and options to acquire our common stock issued to non-employees as a current period expense;

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- o accounting for and disclosing the fair value of shares issued to a former Director in exchange for previously incurred debt;
- o accounting for and disclosing the fair value of warrants issued to note holders and consultants having registration rights; and
- o accounting for and disclosing the revaluation for warrant liabilities as of each reporting period.

Based on the impact of the aforementioned accounting errors, we determined to restate our consolidated financial statements as of September 30, 2005 and the year then ended and the period September 16, 2002 (date of inception as a development stage company) through September 30, 2005.

b) Changes in internal controls. Except as described below, there were no changes in internal controls over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially effect, our internal control over financial reporting.

### Significant Deficiencies In Disclosure Controls and Procedures or Internal Controls

In addition to the remedial measures undertaken during the three months ended June 30, 2006 we previously disclosed in our Current Report on Form 8-K/A filed on May 18, 2006, that we have subsequently implemented the following additional measures to address the identified material weaknesses:

- o We reviewed all convertible securities to identify any securities that may have embedded beneficial conversion features or derivatives; and
- o We have improved the supervision and training of our accounting staff to understand and implement applicable accounting requirements, policies and procedures applicable to the accounting and disclosure of convertible securities and derivatives.

Item 8B -- Other Information  
None.

33

## ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS.

The following is a list of our directors, executive officers and significant employees.

Name	Age	Title	Board of Directors
Jun-Jei Sheu	40	Chairman of the Board	Director
James A. Hayward	53	Chief Executive Officer	Director
Sanford R. Simon	63		Director
Yacov Shamash	56		Director

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Ming-Hwa Benjamin Liang

43

Secretary and Strategic  
Technology Development Officer

Directors are elected to serve until the next annual meeting of stockholders and until their successors are elected and qualified. Currently there are four seats on our board of directors.

Currently, the members of our board of directors do not receive any fees for being a director or attending meetings. Our directors are reimbursed for out-of-pocket expenses relating to attendance at meetings. Officers are elected by the Board of Directors and serve until their successors are appointed by the Board of Directors. Biographical resumes of each officer and director are set forth below.

Chairman of the Board - Jun-Jei Sheu

On July 15, 2005, Dr. Jun-Jei Sheu was appointed as a director and elected Chairman by the board of directors. Since November 2000, Dr. Sheu has been the Chairman of Biowell Technology Inc. Between November 2000 and August 2005, Dr. Sheu was the Chief Executive Officer of Biowell Technology Inc. Dr. Sheu received his bachelor's degree in Biology from Fu-Jen Catholic University in 1988, his Masters degree in Biology from Fu-Jen Catholic University in 1990, his Ph.D in Life Sciences from Intermural of Academia Sinica & National Defense Medical Center in 1996 and his MBA from South Australia University in 2000. Dr. Sheu is also a director of Biowell Technology (S) Pte Ltd., a Singapore company, Biotechcard International Pte (S) Ltd. a Singapore company, Yan Zhan Life Technology & Marketing Inc., a Taiwanese company and Biowell Technology (Suzhou) Co. Ltd., a Chinese company, all of which are biotechnology companies.

Chief Executive Officer - James A. Hayward

Dr. James A. Hayward has been our Chief Executive Officer since March 17, 2006, prior to which he was acting Chief Executive Officer since October 5, 2005. Since January 2006, Dr. Hayward has served as the part-time President of Dr. Suwelack Skin and Healthcare, a private company that manufactures biological matrices for wound care and skin care in Billerbeck, Germany. Since June 2004, Dr. Hayward has been the Chairman of Evotope Biosciences, Inc., a drug development company based in Stony Brook, New York. Since 2001, Dr. Hayward has been a director of Q-RNA, Inc., a biotech company based in New York, New York. Since 2000, Dr. Hayward has been a General Partner of Double D Venture Fund, a venture capital firm based in New York, New York. Between 1990 and July 2004, Dr. Hayward was the Chairman, President and CEO of The Collaborative Group, Ltd., a provider of products and services to the biotechnology, pharmaceutical and consumer-product industries based in Stony Brook, New York. Dr. Hayward received his bachelor's degree in Biology and Chemistry from the State University of New York at Oneonta in 1976, his Ph.D. in Molecular Biology from the State University of New York at Stony Brook in 1983, and an honorary Doctor of Science from Stony Brook in 2000. Dr. Hayward has served on the boards of the Council on Biotechnology, the Long Island Association, the Stony Brook Foundation, the Research Foundation of State University of New York Board of Directors, the New York Biotechnology Association, the Long Island Life Sciences Initiative and the Ward Melville Heritage Organization.

Director - Yacov Shamash

Dr. Yacov Shamash has been a member of the board of directors since March 17, 2006. Dr. Shamash is Vice President of Economic Development at the State University of New York at Stony Brook. Since 1992, he has been the Dean of Engineering and Applied Sciences and the Harriman School for Management and

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Policy at the University, and Founder of the New York State Center for Excellence in Wireless Technologies at the University. Dr. Shamash developed and directed the NSF Industry/University Cooperative Research Center for the Design of Analog/Digital Integrated Circuits from 1989 to 1992 and also served as Chairman of the Electrical and Computer

34

Engineering Department at Washington State University from 1985 until 1992. Dr. Shamash also serves on the Board of Directors of Keytronic Corp., Netsmart Technologies, Inc., American Medical Alert Corp., and Softheon Corp.

Director - Sanford R. Simon

Dr. Sanford R. Simon has been a member of the board of directors since March 17, 2006. Dr. Simon has been a Professor of Biochemistry, Cell Biology and Pathology at Stony Brook since 1997. He joined the faculty at Stony Brook as an Assistant Professor in 1969 and was promoted to Associate Professor with tenure in 1975. Dr. Simon was a member of the Board of Directors of The Collaborative Group from 1995 to 2004. From 1967 to 1969 Dr. Simon was a Guest Investigator at Rockefeller University. Dr. Simon received a B.A. in Zoology and Chemistry from Columbia University in 1963, a Ph.D. in Biochemistry from Rockefeller University in 1967, and studied as a postdoctoral fellow with Nobel Prize winner Max Perutz in Cambridge, England.

Secretary and Strategic Technology Development Officer - Ming-Hwa Benjamin Liang

Ming-Hwa Benjamin Liang has been our Secretary and Strategic Technology Development Officer since October 2005. Between May 1999 and September 2005, Mr. Liang has been the director of research and development at Biowell Technology Inc. Mr. Liang received a B.S. in Bio-Agriculture from Colorado State University in 1989, a M.S. in Horticulture from the University of Missouri at Columbia in 1991, his Ph.D. in Plant Science from the University of Missouri at Columbia in 1997 and his LL.M. in Intellectual Property Law from Shih Hsin University, Taiwan in 2004.

Code of Ethics

The Company has not yet adopted a Code of Ethics. The Company's Board of Directors is in the process of reviewing whether it should adopt a Code of Ethics given the scale and character of its operations at this time.

COMPLIANCE WITH SECTION 16(A) OF THE SECURITIES EXCHANGE ACT OF 1934

Since we are governed under Section 15(d) of the Exchange Act, we are not required to file reports of executive officers and directors and persons who own more than 10% of a registered class of the Company's equity securities pursuant to Section 16(a) of the Exchange Act.

35

ITEM 10. EXECUTIVE COMPENSATION.

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The following table sets forth the compensation paid by us during the fiscal years ended September 30, 2006, 2005 and 2004 to our Chief Executive Officer and our former Chief Executive Officer. No executive officer of the Company received total salary and bonus in excess of \$100,000 during the fiscal year ended September 30, 2006.

### SUMMARY COMPENSATION TABLE

Name and Principal Position	Fiscal Year	Annual Compensation			Long-Term Compensation		Payo
		Annual Salary (\$)	Annual Bonus (\$)	Other Annual Compensation (\$)	Awards	Securities Underlying Options/SARs (#)	
					Restricted Stock Awards (\$)		LTI Pay (\$)
James A. Hayward,	2006	0	0	0	0	7,500,000	0
CEO (1)	2005	0	0	0	0	0	0
	2004	0	0	0	0	0	0

(1) James A. Hayward was appointed as Chief Executive Officer on October 5, 2005.

The Board of Directors, in their discretion, may award stock and stock options to key executives for achieving financing or expenditure guidelines, meeting our business plan objectives, as part of their compensation for employment or for retention purposes.

Employment Agreements

None.

36

### ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The following table sets forth certain information regarding the shares of our common stock beneficially owned as of September 30, 2006, (i) by each person who is known to us to beneficially own more than 5% of the outstanding common stock, (ii) by each of the executive officers named in the table under "Executive Compensation" and by each of our directors, and (iii) by all officers and directors as a group.

NAME AND ADDRESS OF BENEFICIAL OWNER	TITLE OF CLASS	NUMBER OF SHARES OWNED	PERCENTAGE OF CLASS
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		(1)	(2)
Jun-Jei Sheu 25 Health Sciences Drive, Suite 113 Stony Brook, New York 11790	Common Stock	3,113,695 (3)	2.57%
James A. Hayward 25 Health Sciences Drive, Suite 113 Stony Brook, New York 11790	Common Stock	7,759,400 (4)	6.40%
Yacov Shamash 25 Health Sciences Drive, Suite 113 Stony Brook, New York 11790	Common Stock	250,000 (5)	0.21%
Sanford R. Simon 25 Health Sciences Drive, Suite 113 Stony Brook, New York 11790	Common Stock	250,000 (5)	0.21%
All directors and officers as a group (4 persons)	Common Stock	11,373,095 (6)	9.39%

(1) Beneficial ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to the shares shown. Except as indicated by footnote and subject to community property laws where applicable, to our knowledge, the stockholders named in the table have sole voting and investment power with respect to all common stock shares shown as beneficially owned by them. A person is deemed to be the beneficial owner of securities that can be acquired by such person within 60 days upon the exercise of options, warrants or convertible securities (in any case, the "Currently Exercisable Options"). Each beneficial owner's percentage ownership is determined by assuming that the Currently Exercisable Options that are held by such person (but not those held by any other person) have been exercised and converted.

(2) Based upon 121,162,385 shares issued and outstanding on December 29, 2006.

(3) Includes 315,859 shares owned by his wife and 254,354 shares owned by his minor children. Also includes 1,500,000 shares owned by Biowell, of which company Dr. Sheu is deemed a beneficial owner.

(4) Includes 7,500,000 shares underlying currently exercisable warrants.

(5) Includes 250,000 shares underlying a currently exercisable warrant.

(6) Includes 8,000,000 shares underlying currently exercisable options and warrants.

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### EQUITY COMPENSATION PLAN INFORMATION

#### 2002 Professional/Employee/Consultant Compensation Plan

In November of 2002, we created a special compensation plan to pay the founders, consultants and professionals that had been contributing valuable services to us during the previous nine months. This plan, under which 2,000,000 shares of our common stock were reserved for issuance, is called the Professional/Employee/Consultant Compensation Plan (the "Compensation Plan"). Share and option issuances from the Compensation Plan were to be staggered over the following six to eight months, and consultants that were to continue providing services thereafter either became employees or received renewed contracts from us in July of 2003, which contracts contained a more traditional cash compensation component. Each qualified and eligible recipient of shares and/or options under the Compensation Plan received securities in lieu of cash payment for services. Each recipient agreed, in his or her respective consulting contract with us, to sell a limited number of shares monthly.

In our financial statements, shares that are disclosed as having been issued from November 2002 through June 30, 2003 that were valued at \$0.65 per share were shares issued from the Compensation Plan on the basis of contracts executed at that time for previously rendered services. Common Stock disclosed as being issued in exchange for cash at \$1.00 per share represent options that were exercised under the Compensation Plan. In December of 2004, we adjusted the exercise price of options under the Compensation Plan to \$0.60 per share. As of October 31, 2006, a total of 1,440,000 shares have been issued from, and options to purchase 560,000 shares have been issued under the Compensation Plan, and options to purchase 264,000 shares have been exercised as of that date.

#### 2005 Incentive Stock Plan

On January 26, 2005, the Board of Directors, and on February 15, 2005, the holders of a majority of the outstanding common stock of the Company approved the Company's 2005 Incentive Stock Plan and authorized the issuance of 16,000,000 shares of common stock as stock awards and stock options thereunder. The 2005 Incentive Stock Plan is designed to retain directors, executives, and selected employees and consultants by rewarding them for making contributions to our success with an award of shares of our common stock. As of October 31, 2006, a total of 8,550,000 shares have been issued and options to purchase 5,660,000 shares have been granted under the 2005 Incentive Stock Plan.

During the months of March, May, July and August 2005, we issued a total of 8,550,000 shares of our common stock to certain employees and consultants pursuant to the 2005 Incentive Stock Plan. We engaged our outside counsel to conduct an investigation of the circumstances surrounding the issuance of these shares. On April 26, 2006, we voluntarily reported the findings from this investigation to the SEC, and agreed to provide the SEC with further information arising from the investigation. We believe that the issuance of 8,000,000 shares to employees in July 2005 was effectuated by both our former President and our former Chief Financial Officer/Chief Operating Officer without approval of our board of directors. These former officers received a total of 3,000,000 of these shares. In addition, it appears that the 8,000,000 shares issued in July 2005, as well as an additional 550,000 shares issued to employees and consultants in March, May and August 2005, were improperly issued without a restrictive legend stating that the shares could not be resold legally except in compliance with the Securities Act of 1933, as amended. The members of the Company's management who effectuated the stock issuances no longer work for the Company. These shares were not registered under the Securities Act of 1933, or the securities laws of any state, and we believe that certain of these shares may have been sold on the open market, though we have been unable to determine the magnitude of such sales. If violations of securities laws occurred in

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connection with the resale of certain of these shares, the employees and consultants or persons who purchased shares from them may have rights to have their purchase rescinded or other claims against us for violation of securities laws, which could harm our business, results of operations, and financial condition.

38

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number Remainin Future Equity Co (Exclud Reflecte
	(a)	(b)	
Professional/Consultant/Employee Stock and Stock Option Compensation Plan approved in November 2002	296,000	\$0.60	
2005 Incentive Stock Plan approved on January 26, 2005	5,660,000	\$0.47	
Total	5,956,000	\$0.59	

39

### ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

On November 3, 2005, we issued and sold a promissory note in the principal amount of \$550,000 to Allied International Fund, Inc. ("Allied"). Allied in turn financed a portion of its making of this loan by borrowing \$450,000 from certain persons, including \$100,000 from James A. Hayward, a director and our Chief Executive Officer. The terms of the promissory note provided that we issue upon the funding of the note warrants to purchase 5,000,000 shares of our common stock at an exercise price of \$0.50 per share to certain persons designated by Allied. On November 9, 2005, we issued nine warrants to Allied and eight other persons to purchase an aggregate of 5,500,000 shares of our common stock at an exercise price of \$0.50 per share. These warrants included a warrant to purchase 1,100,000 shares that was issued to James A. Hayward, a director and our Chief Executive Officer. Additionally, we



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paid \$55,000 in cash to VC Arjent, Ltd. for its services as the placement agent with respect to this placement. All principal and accrued but unpaid interest under the promissory note was paid in full shortly after the closing of and from the proceeds of a private placement we completed on March 8, 2006.

In February 2005, we entered into an agreement with The Research Foundation of the State University of New York acting on behalf of Stony Brook University ("The Research Foundation") to support a project entitled "A Chimeric Method and System for DNA Encryption and Authentication." Pursuant to this agreement, the Research Foundation made a grant of \$79,005.77 to us to support the project, which amount is payable over six months. Upon approval from The Research Foundation, we will receive an additional grant of \$80,000, payable over one year. On July 31, 2006, we received an additional grant of \$79,005.07 for use by us during the period from July 1, 2006 to July 1, 2007. The general objective of this project is to further extend the application of chimeric DNA methodologies in different product applications such as ink and thread. Dr. Sanford R. Simon, Professor of Biochemistry, Cell Biology, and Pathology at Stony Brook University and one of our directors, will lead this project on behalf of Stony Brook University together with Dr. Benjamin Liang, our Strategic Technology Development Officer.

On March 29, 2006 and April 13, 2006, we borrowed \$200,000 in the aggregate, at a rate of 7.5% per annum, from BioCogent whose President and Chief Executive Officer and sole stockholder is James A. Hayward, one of our directors and our Chief Executive Officer. These loans were due and payable upon the earlier to occur of (1) the close of business on June 30, 2006, or (2) the closing of the issuance and sale of our securities for gross proceeds of at least \$250,000. The proceeds from the loans were used for general corporate purposes. The note issued on March 29, 2006 was repaid with interest in May, 2006. The note issued on April 13, 2006 was repaid with interest in June, 2006.

In May, 2006, we signed a Business Development and Trademark License Agreement with Dr. Suwelack Skin & Health Care AG ("Dr. Suwelack") providing Dr. Suwelack 170,000 shipping labels marked with the SigNature logo using SigNature DNA Ink, and a limited, non-exclusive, non-transferable right to use the SigNature logo via these labels on its packaging. Dr. Suwelack agreed to pay us (euro)15,000 for these labels and rights. (euro)7,500 of this amount was paid upon signing of the agreement and the remaining 50% is due upon Dr. Suwelack's receipt of the shipping labels. James A. Hayward, a director and our Chief Executive Officer, serves on Dr. Suwelack's board of directors. BioCogent, whose President and Chief Executive Officer and sole stockholder is Dr. Hayward, provides consulting services to Dr. Suwelack.

On September 1, 2006, we issued warrants to purchase an aggregate of 18,400,000 shares of our common stock exercisable for a period of five years commencing on September 1, 2006, at a price of \$0.09 per share, the closing price of our common stock on the date of issuance. Each such warrant provides its holder unlimited piggyback registration rights with respect to any registration statement we file. These warrants include a warrant to purchase an aggregate of 6,400,000 shares of our common stock that was issued to James A. Hayward, a director and our Chief Executive Officer. The Company also issued a warrant to purchase 250,000 shares of our common stock to each of Sanford R. Simon and Yacov Shamash, each of whom is one of our directors. Each of these warrants is exercisable for a period commencing on March 17, 2007, and expiring on August 31, 2011, at a price of \$0.09 per share, the closing price of our common stock on the date of issuance of the warrants, and provide its holder unlimited piggyback registration rights with respect to any registration statement filed by the Company.

We have no policy regarding entering into transactions with affiliated parties.

ITEM 13. EXHIBITS.

Exhibit	Description
2.1	Articles of Merger of Foreign and Domestic Corporations, filed December 19, 1998 with the Nevada Secretary of State, filed as an exhibit to the annual report on Form 10-KSB filed with the Commission on December 29, 2003 and incorporated herein by reference.
3.1	Articles of Incorporation of DCC Acquisition Corporation, filed April 20, 1998 with the Nevada Secretary of State, filed as an exhibit to the annual report on Form 10-KSB filed with the Commission on December 29, 2003 and incorporated herein by reference.
3.2	Articles of Amendment of Articles of Incorporation of DCC Acquisition Corp. changing corporation name to ProHealth Medical Technologies, Inc.
3.3	Certificate of Designations, Powers, preferences and Rights of the Founders' Series of Convertible Preferred Stock, filed as an exhibit to the annual report on Form 10-KSB filed with the Commission on December 29, 2003 and incorporated herein by reference.
3.4	Articles of Amendment of Articles of Incorporation of Applied DNA Sciences, Inc. increasing the par value of the company's common stock, filed on December 3, 2003 with the Nevada Secretary of State, filed as an exhibit to the annual report on Form 10-KSB filed with the Commission on December 29, 2003 and incorporated herein by reference.
3.5	By-Laws of Applied DNA Sciences, Inc., filed as an exhibit to the annual report on Form 10-KSB filed with the Commission on December 29, 2003 and incorporated herein by reference.
4.1	Form of Subscription Agreement, filed as an exhibit to the current report on Form 8-K filed with the Commission on January 28, 2005 and incorporated herein by reference.
4.2	Form of 10% Secured Convertible Promissory Note, filed as an exhibit to the current report on Form 8-K filed with the Commission on January 28, 2005 and incorporated herein by reference.
4.3	Form of Warrant Agreement, filed as an exhibit to the current report on Form 8-K filed with the Commission on January 28, 2005 and incorporated herein by reference.
4.4	Registration Rights Agreement, dated January 28, 2005, between the Company and Vertical Capital Partners, Inc., on behalf of the investors, filed as an exhibit to the current report on Form 8-K filed with the Commission on January 28, 2005 and incorporated herein by reference.
4.5	Security Agreement, dated January 28, 2005, between the Company and Vertical Capital Partners, Inc., on behalf of the investors, filed

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as an exhibit to the current report on Form 8-K filed with the Commission on January 28, 2005 and incorporated herein by reference.

- 10.1 Exclusive License Agreement between Biowell Technology Corp. and Applied DNA Sciences, Inc. executed on October 8, 2002, filed as an exhibit to the registration statement on Form SB-2 filed with the Commission on February 15, 2005 and incorporated herein by reference.
- 10.2 Sub-License Agreement with G. A. Corporate Finance Ltd. Applied DNA Sciences, Inc., executed on July 29, 2003, as amended, filed as an exhibit to the current report on Form 8-K filed with the Commission on September 29, 2003 and incorporated herein by reference.
- 10.3 Indemnification Agreement with Larry Lee, filed as an exhibit to the registration statement on Form SB-2 filed with the Commission on February 15, 2005 and incorporated herein by reference.

41

- 10.4 Indemnification Agreement with Robin Hutchison, filed as an exhibit to the registration statement on Form SB-2 filed with the Commission on February 15, 2005 and incorporated herein by reference.
- 10.5 Indemnification Agreement with Peter Brocklesby, filed as an exhibit to the registration statement on Form SB-2 filed with the Commission on February 15, 2005 and incorporated herein by reference.
- 10.6 Indemnification Agreement with Adrian Botash, filed as an exhibit to the registration statement on Form SB-2 filed with the Commission on February 15, 2005 and incorporated herein by reference.
- 10.7 Stock Purchase Agreement, dated as of January 28, 2005, by and between Applied DNA Sciences, Inc. and Biowell Technology, Inc., filed as an exhibit to the current report on Form 8-K filed with the Commission on February 2, 2005 and incorporated herein by reference.
- 10.8 Investment Advisory Agreement, dated as of February 14, 2005, by and between Applied DNA Sciences, Inc. and First London Finance, Ltd., filed as an exhibit to the registration statement on Form SB-2 filed with the Commission on February 15, 2005 and incorporated herein by reference.
- 10.9 Amendment to the License Agreement, dated as of November 2, 2004, by and between Applied DNA Sciences, Inc. and Biowell Technology Inc., filed as an exhibit to the registration statement on Form SB-2 filed with the Commission on June 16, 2005 and incorporated herein by reference.
- 10.10 Joint Product Development and Marketing Agreement, dated as of November 10, 2004, by and between Applied DNA Sciences, Inc. and Hologrammas S.A. de C.V., filed as an exhibit to the registration statement on Form SB-2 filed with the Commission on October 28, 2005 and incorporated herein by reference.
- 10.11 Cooperative Research and Development Agreement, dated as of September 2, 2004, by and between Applied DNA Sciences, Inc. and Bechtel BWXT Idaho, LLC, filed as an exhibit to the registration

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statement on Form SB-2 filed with the Commission on October 28, 2005 and incorporated herein by reference.

- 10.12 Amendment to the Cooperative Research and Development Agreement, dated as of March 24, 2005, by and between Applied DNA Sciences, Inc. and Battelle Energy Alliance, LLC, filed as an exhibit to the current report on Form 8-K filed with the Commission on May 10, 2005 and incorporated herein by reference.
- 10.13 Stock Purchase Amendment Agreement, dated as of July 12, 2005, by and between Applied DNA Sciences, Inc. and Biowell Technology, Inc., filed as an exhibit to the current report on Form 8-K filed with the Commission on July 21, 2005 and incorporated herein by reference.
- 10.14 License Agreement, dated as of July 12, 2005, by and between Applied DNA Sciences, Inc. and Biowell Technology, Inc., filed as an exhibit to the current report on Form 8-K filed with the Commission on July 21, 2005 and incorporated herein by reference.
- 10.15 Amendment to the License Agreement, dated as of October 10, 2005, by and between Applied DNA Sciences, Inc. and Biowell Technology, Inc., filed as an exhibit to the registration statement on Form SB-2 filed with the Commission on October 28, 2005 and incorporated herein by reference.
- 10.16 Consulting Agreement, dated as of July 12, 2005, by and between Applied DNA Sciences, Inc. and Timpix International Limited, filed as an exhibit to the current report on Form 8-K filed with the Commission on July 21, 2005 and incorporated herein by reference.

42

- 10.17 Letter of Engagement, dated as of June 20, 2005, by and between Applied DNA Sciences, Inc. and Trilogy Capital Partners, Inc., filed as an exhibit to the current report on Form 8-K filed with the Commission on July 21, 2005 and incorporated herein by reference.
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14 and Rule 15d-14(a), promulgated under the Securities and Exchange Act of 1934, as amended
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14 and Rule 15d-14(a), promulgated under the Securities and Exchange Act of 1934, as amended
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)

43

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### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The following table sets forth fees billed to us by our auditors during the fiscal years ended September 30, 2006 and 2005 for: (i) services rendered for the audit of our annual financial statements and the review of our quarterly financial statements, (ii) services by our auditor that are reasonably related to the performance of the audit or review of our financial statements and that are not reported as Audit Fees, (iii) services rendered in connection with tax compliance, tax advice and tax planning, and (iv) all other fees for services rendered.

	September 30, 2006	September 30, 2005
(i) Audit Fees	\$221,362	\$134,341
(ii) Audit Related Fees	\$34,500	-
(iii) Tax Fees	-	-
(iv) All Other Fees	-	-
Total Fees	\$255,862	\$134,341

#### Audit Fees

Consists of fees billed for professional services rendered for the audit of the Company's consolidated financial statements and review of the interim consolidated financial statements included in quarterly reports and services that are normally provided by Russell Bedford Stefanou Mirchandani LLP in connection with statutory and regulatory filings or engagements.

#### Audit Related Fees

Consists of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of the Company's consolidated financial statements and are not reported under "Audit Fees." These services consist of responding to SEC comments and the review of and consent to registration statements.

#### Tax Fees

Consists of fees billed for professional services for tax compliance, tax advice and tax planning.

#### All Other Fees

Consists of fees for products and services other than the services reported above. There were no management consulting services provided in fiscal 2006 or 2005.

The Board of Directors has considered whether the provision of non-audit services is compatible with maintaining the principal accountant's independence.

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### Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors

The Company currently does not have a designated Audit Committee, and accordingly, the Company's Board of Directors' policy is to pre-approve all audit and permissible non-audit services provided by the independent auditors. These services may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. The independent auditors and management are required to periodically report to the Company's Board of Directors regarding the extent of services provided by the independent auditors in accordance with this pre-approval, and the fees for the services performed to date. The Board of Directors may also pre-approve particular services on a case-by-case basis.

44

### Signatures

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

APPLIED DNA SCIENCES, INC.

Date: January 16, 2007

/s/JAMES A. HAYWARD

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James A. Hayward  
Chief Executive Officer  
(Principal Executive Officer)  
and Chief Financial Officer  
(Principal Financial Officer  
and Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Position
/s/ JAMES A. HAYWARD -----	Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)
/s/ JUN-JEI SHEU ----- Jun-Jei Sheu	Chairman of the Board of Directors
/s/ YACOV SHAMASH ----- Yacov Shamash	Director

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/s/ SANFORD R. SIMON

Director

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Sanford R. Simon