

APPLIED DNA SCIENCES INC
Form 10-Q
February 15, 2008
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended December 31, 2007

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the Transition Period From _____ To _____

Commission file number 002-90519

APPLIED DNA SCIENCES, INC.

(Name of small business issuer in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

**25 Health Sciences Drive, Suite 113
Stony Brook, New York**
(Address of Principal Executive Offices)

59-2262718
(I.R.S. Employer
Identification Number)

11790
(Zip Code)

(631) 444-6861

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(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the last 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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of Common Stock, \$0.001 par value, outstanding on February 11, 2008, was 190,761,603 shares.

Transitional Small Business Disclosure Format (Check one)

Yes No

APPLIED DNA SCIENCES, INC
QUARTERLY REPORT ON FORM 10-QSB FOR THE
QUARTERLY PERIOD ENDING DECEMBER 31, 2007

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PART I. FINANCIAL INFORMATION**Item 1. FINANCIAL STATEMENTS (UNAUDITED)****APPLIED DNA SCIENCES, INC.
CONDENSED CONSOLIDATED BALANCE SHEET**

	(unaudited) December 31, <u>2007</u>	September 30, <u>2007</u>
ASSETS		
Current assets:		
Cash	\$ 845,652	\$ 25,185
Accounts Receivable	14,007	-
Prepaid expenses	63,125	101,000
Restricted cash	<u>299,920</u>	<u>399,920</u>
Total current assets	1,222,704	526,105
Property, plant and equipment-net of accumulated depreciation of \$97,967 and \$82,825, respectively	95,886	105,537
Other assets:		
Deposits	8,322	13,822
Capitalized finance costs-net of accumulated amortization of \$68,589	366,411	29,503
Intangible assets:		
Patients, net of accumulated amortization of \$27,158 and \$25,445, respectively (Note B)	7,099	8,812
Intellectual property, net of accumulated amortization and write off of \$7,793,839 and \$7,702,891, respectively (Note B)	<u>1,637,061</u>	<u>1,728,009</u>
Total Assets	\$ 3,337,483	\$ 2,411,788
LIABILITIES AND DEFICIENCY IN STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 12,360,093	\$ 13,215,975
Convertible notes payable, net of unamortized discount (Note D)	2,237,042	740,405
Other current liabilities	<u>299,920</u>	<u>399,920</u>
Total current liabilities	14,897,055	14,356,300
Commitments and contingencies (Note J)		
Deficiency in Stockholders' Equity- (Note F)		
Preferred stock, par value \$0.0001 per share; 10,000,000 shares authorized; 60,000 issued and outstanding	6	6
Common stock, par value \$0.001 per share; 410,000,000 shares authorized; 190,761,603 and 180,281,661 issued and outstanding as of December 31, 2007 and September 30, 2007, respectively	190,761	180,281
Additional paid in capital	130,955,788	128,448,584
Accumulated deficit	<u>(142,706,127)</u>	<u>(140,573,383)</u>
Total deficiency in stockholders' equity	(11,559,572)	(11,944,512)
Total liabilities and Deficiency in Stockholders' Equity	\$ 3,337,483	\$ 2,411,788

See the accompanying notes to the condensed consolidated financial statements

APPLIED DNA SCIENCES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF LOSSES
(unaudited)

	Three Months Ended December 31,	
	<u>2007</u>	<u>2006</u>
Sales	\$ 123,167	\$ -
Cost of sales	<u>(27,890)</u>	=
Gross Profit	95,277	-
Operating expenses:		
Selling, general and administrative	1,698,269	2,054,455
Research and development	36,326	29,306
Depreciation and amortization	<u>107,804</u>	<u>107,879</u>
Total operating expenses	<u>1,842,399</u>	<u>2,191,640</u>
NET LOSS FROM OPERATIONS	(1,747,122)	(2,191,640)
Net gain in revaluation of debt derivative and warrant liabilities	-	2,098,471
Other income	-	977
Interest expense	<u>(385,622)</u>	<u>(579,030)</u>
Net loss before provision for income taxes	(2,132,744)	(671,222)
Income taxes (benefit)	=	=
NET LOSS	\$ (2,132,744)	\$ (671,222)
Net (loss) per share-basic and fully diluted	\$ (0.01)	\$ (0.01)
Weighted average shares outstanding-		
Basic and fully diluted	182,131,200	121,021,515
See the accompanying notes to the condensed consolidated financial statements		

APPLIED DNA SCIENCES, INC.
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(unaudited)

	Three months ended December 31,	
	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:		
Net loss	\$ (2,132,744)	\$ (671,222)
Adjustments to reconcile net loss to net used in operating activities:		
Depreciation and amortization	107,804	107,879
Income attributable to repricing of warrants and debt derivatives	-	(2,098,471)
Amortization of capitalized financing costs	60,592	388,775
Amortization of debt discount attributable to convertible debentures	324,047	455,400

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Common stock issued in exchange for services rendered	1,040,000	-
Change in assets and liabilities:		
Increase in accounts receivable	(14,007)	(977)
Decrease in prepaid expenses and deposits	37,875	40,000
Decrease in other assets	5,500	-
Increase (decrease) in accounts payable and accrued liabilities	<u>(855,607)</u>	<u>1,217,460</u>
Net cash used in operating activities	(1,426,541)	(561,156)
Cash flows from investing activities:		
Decrease in restricted cash held in escrow	100,000	-
Acquisition of property and equipment, net	<u>(5,492)</u>	<u>(11,039)</u>
Net cash provided by (used in) investing activities	94,508	(11,039)
Cash flows from financing activities:		
Proceeds from issuance of convertible notes	<u>2,152,500</u>	=
Net cash provided by financing activities	2,152,500	-
Net increase in cash and cash equivalents	820,467	(572,195)
Cash and cash equivalents at beginning of period	<u>25,185</u>	<u>1,225,304</u>
Cash and cash equivalents at end of period	\$ 845,652	\$ 653,109
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	1,040,000	-
Common stock issued in exchange for previously incurred debt	50,275	410,429

See the accompanying notes to the condensed consolidated financial statements

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Applied DNA Sciences, Inc.
Notes To Consolidated Financial Statements
December 31, 2007
(unaudited)

NOTE A SUMMARY OF ACCOUNTING POLICIES

General

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-QSB, and therefore, do not include all the information necessary for a fair presentation of financial position, results of operations and cash flows in conformity with generally accepted accounting principles.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended December 31, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2008. The unaudited condensed consolidated financial statements should be read in

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conjunction with the consolidated September 30, 2007 financial statements and footnotes thereto included in the Company's SEC Form 10-KSB.

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. During the year ended September 30, 2007, the Company transitioned from a development stage enterprise to an operating company. The Company is principally devoted to developing DNA embedded biotechnology security solutions in the United States. To date, the Company has generated minimum sales revenues from its services and products; it 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 December 31, 2007, the Company has accumulated losses of \$142,706,127.

The consolidated financial statements include the accounts of the Company, and its wholly-owned subsidiaries Applied DNA Operations Management, Inc., APDN (B.V.I.), Inc. and Applied DNA Sciences Europe Limited. Significant inter-company 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

Revenues are derived from research, development, qualification and production testing for certain commercial products. Revenue from fixed price testing contracts is generally recorded upon completion of the contracts, which are generally short-term, or upon completion of identifiable contractual tasks. At the time the Company enters into a contract that includes multiple tasks, the Company estimates the amount of actual labor and other costs that will be required to complete each task based on historical experience. Revenues are recognized which provide for a profit margin relative to the testing performed. Revenue relative to each task and from contracts which are time and materials based is recorded as effort is expended. Billings in excess of amounts earned are deferred. Any anticipated losses on contracts are charged to income when identified. To the extent management does not accurately forecast the level of effort required to complete a contract, or individual tasks within a contract, and the Company is unable to negotiate additional billings with a customer for cost over-runs, the Company may incur losses on individual contracts. All selling, general and administrative costs are treated as period costs and expensed as incurred.

For revenue from product sales, the Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, REVENUE RECOGNITION ("SAB104"), which superseded Staff Accounting Bulletin No. 101, REVENUE RECOGNITION IN FINANCIAL STATEMENTS ("SAB101"). 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) collectability 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 collectability of those amounts. Provisions for discounts and rebates to customers, estimated

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Applied DNA Sciences, Inc.
Notes To Consolidated Financial Statements
December 31, 2007
(unaudited)

NOTE A SUMMARY OF ACCOUNTING POLICIES (continued)

returns and allowances, and other adjustments are provided for in the same period the related sales are recorded. The Company defers any revenue for which the product has not been delivered or is subject to refund until such time that the Company and the customer jointly determine that the product has been delivered or no refund will be required. At December 31, 2007 the Company did not have any deferred revenue.

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SAB 104 incorporates Emerging Issues Task Force 00-21 (EITF 00-21), MULTIPLE DELIVERABLE REVENUE ARRANGEMENTS. EITF 00-21 addresses accounting for arrangements that may involve the delivery or performance of multiple products, services and/or rights to use assets. The effect of implementing EITF 00-21 on the Company's financial position and results of operations was not significant.

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.

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 December 31, 2007 property and equipment consist of:

Computer equipment	\$	27,404
Lab equipment		60,464
Furniture		105,985
		193,853
Accumulated Depreciation		(97,967)
Net	\$	95,886

Net Loss Per Share

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 245,277,349 and 231,412,185 for the three months ended December 31, 2007 and 2006, 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

NOTE A SUMMARY OF ACCOUNTING POLICIES (continued)

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. For the year ended September 30, 2007; the Company did not issue any stock based compensation.

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.

In adopting SFAS No. 123(R), the Company elected to use the modified prospective method to account for the transition from the intrinsic value method to the fair value recognition method. Under the 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 three months ended December 31, 2007, the Company did not grant employee stock options.

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 its trade receivables in determining its allowance for doubtful accounts. At December 31, 2007, allowance for doubtful receivable 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 \$36,326 and \$29,306 for the three months ended December 31, 2007 and 2006, respectively.

Reclassifications

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

Advertising

The Company follows the policy of charging the costs of advertising to expense as incurred. The Company charged to operations \$2,246 and \$10,786 as advertising costs for the three months ended December 31, 2007 and 2006, respectively.

Applied DNA Sciences, Inc.
Notes To Consolidated Financial Statements
December 31, 2007
(unaudited)

NOTE A SUMMARY OF ACCOUNTING POLICIES (continued)

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.

Restricted cash / other current liabilities

Restricted cash is comprised of funds deposited into an escrow account pending consummation of the placement of convertible debt as of December 31, 2007 (see Note L). The related obligation is recorded as other current liabilities until consummation.

Derivative Financial Instruments

The Company's derivative financial instruments consisted of embedded derivatives related to the 10% Secured Convertible Promissory Notes (the "Serial Notes") issued in 2006. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments required that the Company record 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 was required to classify all other non-employee stock options and warrants as derivative liabilities and mark them to market at each reporting date. Any change in fair value was 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 recorded a non-operating, non-cash charge. If the fair value of the derivatives is lower at the subsequent balance sheet date, the Company recorded 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 were classified as long-term liabilities.

In December 2006, the FASB issued FSP EITF 00-19-2, Accounting for Registration Payment Arrangements ("FSP 00-19-2") which addresses accounting for registration payment arrangements. FSP 00-19-2 specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, Accounting for Contingencies. FSP 00-19-2 further clarifies that a financial instrument subject to a registration payment arrangement should be accounted for in accordance with other applicable generally accepted accounting principles without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement. For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of EITF 00-19-2, this guidance shall be effective for financial statements issued for fiscal years beginning after December 15, 2006 and interim periods within those fiscal years.

In September 2007, the Company exchanged common stock for the remaining Secured Convertible Promissory Notes that contained embedded derivatives such as certain conversion features, variable interest features, call options and default provisions as described above. As a result, the Company reclassified the warrant liabilities recorded in conjunction with the convertible promissory notes to equity as of the conversion date of the related debt. Additionally, the Company has an accumulative accrual of \$11,750,941 in liquidating damages in relationship to the previously outstanding convertible promissory notes and related warrants.

Applied DNA Sciences, Inc.
Notes To Consolidated Financial Statements
December 31, 2007
(unaudited)

NOTE A SUMMARY OF ACCOUNTING POLICIES (continued)

New Accounting Pronouncements

In December 2006, the FASB issued FSP EITF 00-19-2, Accounting for Registration Payment Arrangements ("FSP 00-19-2") which addresses accounting for registration payment arrangements. FSP 00-19-2 specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, Accounting for Contingencies. FSP 00-19-2 further clarifies that a financial instrument subject to a registration payment arrangement should be accounted for in accordance with other applicable generally accepted accounting principles without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement. For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of EITF 00-19-2, this guidance shall be effective for financial statements issued for fiscal years beginning after December 15, 2006 and interim periods within those fiscal years. The Company adopted FSP 00-19-2 in the preparation of the financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS 159 permits entities to choose to measure many financial instruments, and certain other items, at fair value. SFAS 159 applies to reporting periods beginning after November 15, 2007. The adoption of SFAS 159 is not expected to have a material impact on the Company's financial condition or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), "*Business Combinations*" ("SFAS No. 141(R)"), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. SFAS No. 141R is effective as of the beginning of the first fiscal year beginning on or after December 15, 2008. Earlier adoption is prohibited and the Company is currently evaluating the effect, if any, that the adoption will have on its financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160, "*Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51*" ("SFAS No. 160"), which will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity within the consolidated balance sheets. SFAS No. 160 is effective as of the beginning of the first fiscal year beginning on or after December 15, 2008. Earlier adoption is prohibited and the Company is currently evaluating the effect, if any, that the adoption will have on its financial position, results of operations or cash flows.

NOTE B - ACQUISITION OF INTANGIBLE ASSETS

The Company has adopted SFAS No. 142, Goodwill and Other Intangible Assets, whereby the Company periodically tests 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.

The identifiable intangible assets acquired and their carrying value at December 31, 2007 is:

Applied DNA Sciences, Inc.
Notes To Consolidated Financial Statements
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(unaudited)

NOTE B ACQUISITION OF INTANGIBLE ASSETS (continued)

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	(2,165,986)
Impairment (See below)	(5,655,011)
Net:	\$1,644,160	
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 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 for the year ended September 30, 2006, 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 three months ended December 31, 2007 and 2006 were \$92,661 and \$92,661 respectively.

Estimated amortization expense as of December 31, 2007 is as follows:

2008	\$277,982
2009	365,842
2010	363,792
2011	363,792
2012 and thereafter	272,752
Total	\$1,644,160

NOTE C ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at December 31, 2007 are as follows:

Accounts payable	\$234,766
Accrued consulting fees	102,500
Accrued interest payable	80,904
Accrued penalties relating to registration rights liquidating damages	11,750,941

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Other accrued expenses	190,982
Total	\$12,360,093

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Applied DNA Sciences, Inc.
Notes To Consolidated Financial Statements
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NOTE C ACCOUNTS PAYABLE AND ACCRUED LIABILITIES (continued)

Restricted cash/other current liabilities

As described in Note L below, the Company issued 10% Secured Promissory Notes subsequent to December 31, 2007. At December 31, 2007, the Company received \$299,920 held in escrow relating to the placement of convertible notes pending acceptance and completion of the placement of the Notes (See Note L).

Registration Rights Liquidated Damages

In October 2003 and from December 2004 through February 2005, the Company issued Convertible Promissory Notes and attached to the Notes were warrants to purchase the Company's common stock.

The Company agreed to file a registration statement for the common stock underlying the Notes and related warrants as to permit public resale thereof. The registration rights agreement provided for the payment of liquidated damages if the stipulated registration deadlines were not met. The liquidated damages are equal to 3.5% per month, with no limitations.

As of December 31, 2007, the Company has not had a registration statement declared effective relating to the common stock underlying the Notes and related warrants and in accordance with EITF 00-19-2, the Company evaluated the likelihood of achieving registration statement effectiveness. The Company has accrued \$11,750,941 as of December 31, 2007 to account for these potential liquidated damages until the expected effectiveness of the registration statement is achieved.

NOTE D PRIVATE PLACEMENT OF CONVERTIBLE NOTES

Convertible notes payable as of September 30, 2007 are as follows:

10% Secured Convertible Notes Payable, related party, dated April 23, 2007, net of unamortized debt discount of \$16,771 (see below)	\$ 83,229
10% Secured Convertible Notes Payable dated June 27, 2007 (See below)	100,000
10% Secured Convertible Notes Payable dated June 27, 2007 (See below)	50,000
10% Secured Convertible Notes Payable, related party, dated June 30, 2007, net of unamortized debt discount of \$50,757 (see below)	199,243
10% Secured Convertible Notes Payable, related party, dated July 30, 2007, net of unamortized debt discount of \$28,989 (see below)	171,011
	80,349

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10% Secured Convertible Notes Payable, dated August 8, 2007, net of unamortized debt discount of \$19,651 (see below)	
10% Secured Convertible Notes Payable, related party, dated September 28, 2007, net of unamortized debt discount of \$136,750 (see below)	163,250
10% Secured Convertible Notes Payable, dated October 4, 2007, net of unamortized debt discount of \$223,230 (see below)	326,770
10% Secured Convertible Notes Payable, dated October 30, 2007, net of unamortized debt discount of \$304,360 (see below)	295,640
10% Secured Convertible Notes Payable, dated November 29, 2007, net of unamortized debt discount of \$487,055 (see below)	512,945

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Applied DNA Sciences, Inc.
Notes To Consolidated Financial Statements
December 31, 2007
(unaudited)

NOTE D PRIVATE PLACEMENT OF CONVERTIBLE NOTES (continued)

10% Secured Convertible Notes Payable dated December 20, 2007, net of unamortized debt discount of \$195,395 (see below)	254,605	
	2,237,042	
Less: current portion	(2,237,042)
	\$-	

10% Secured Convertible Promissory Note dated April 23, 2007

On April 23, 2007, the Company issued a \$100,000 related party convertible promissory note due April 23, 2008 with interest at 10% per annum due upon maturity. The note is convertible at any time prior to maturity, at the holder's option, at \$0.50 per share. At maturity, the note, including any accrued and unpaid interest, is convertible at \$0.15 per share. The Company has granted the noteholder a security interest in all the Company's assets.

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 note. 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 \$13,333 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 note. The debt discount attributed to the beneficial conversion feature is amortized over the convertible note's maturity period (one year) as interest expense.

In connection with the issuance of the note, the Company issued non-detachable warrants granting the holder the right to acquire 200,000 shares of the Company's common stock at \$0.50 per share. The warrants expire five years from the issuance. In accordance with Emerging Issues Task Force Issue 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments (EITF 0027), the Company recognized the value attributable to the warrants in the amount of \$40,840 to additional paid in capital and a discount against the convertible note. The Company valued the warrants in accordance with EITF 00-27 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 4.55%, a dividend yield of 0%, and volatility of 207.45%. The debt discount attributed to the value of the warrants issued is amortized over the convertible note's maturity period (one year) as interest expense.

The Company recorded the intrinsic value of the embedded beneficial conversion feature (\$13,333) and warrants (\$40,840) to debt discount, aggregating \$54,173, which will be amortized to interest expense over the term of the Notes. Amortization of \$13,655 was recorded for the three months ended December 31, 2007.

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10% Secured Convertible Promissory Notes dated June 27, 2007

On June 27, 2007, the Company issued \$150,000 principal amount convertible promissory notes due June 27, 2007 with interest at 10% per annum due upon maturity. The notes are convertible at any time prior to maturity, at the option of the holders, at \$0.50 per share. At maturity, the note, including any accrued and unpaid interest, is convertible at \$0.15 per share. The Company has granted the noteholders a security interest in all the Company's assets.

In conjunction with the issuance of the notes, the Company issued 300,000 warrants to purchase the Company's common stock at \$0.50 per share over a five year term. The Company valued the warrants using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 4.55%, a dividend yield of 0%, and volatility of 207.45% as a charge against current operations.

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NOTE D PRIVATE PLACEMENT OF CONVERTIBLE NOTES (continued)

10% Secured Convertible Promissory Note dated June 30, 2007

On June 30, 2007, the Company issued a \$250,000 related party convertible promissory note due June 30, 2008 with interest at 10% per annum due upon maturity. The note is convertible at any time prior to maturity, at the holder's option, at \$0.50 per share. At maturity, the note, including any accrued and unpaid interest, is convertible at \$0.0877 per share. The Company has granted the noteholder a security interest in all the Company's assets.

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 note. 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 \$63,454 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 note. The debt discount attributed to the beneficial conversion feature is amortized over the convertible note's maturity period (one year) as interest expense.

In connection with the issuance of the note, the Company issued non-detachable warrants granting the holder the right to acquire 500,000 shares of the Company's common stock at \$0.50 per share. The warrants expire five years from the issuance. In accordance with Emerging Issues Task Force Issue 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments (EITF 0027), the Company recognized the value attributable to the warrants in the amount of \$38,900 to additional paid in capital and a discount against the convertible note. The Company valued the warrants in accordance with EITF 00-27 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 4.92%, a dividend yield of 0%, and volatility of 123.8%. The debt discount attributed to the value of the warrants issued is amortized over the convertible note's maturity period (one year) as interest expense.

The Company recorded the intrinsic value of the embedded beneficial conversion feature (\$63,454) and warrants (\$38,900) to debt discount, aggregating \$102,354, which will be amortized to interest expense over the term of the Notes. Amortization of \$25,799 was recorded for the three months ended December 31, 2007.

10% Secured Convertible Promissory Note dated July 30, 2007

On July 30, 2007, the Company issued a \$200,000 related party convertible promissory note due July 30, 2008 with interest at 10% per annum due upon maturity. The note is convertible at any time prior to maturity, at the holder's option, at \$0.50 per share. At maturity, the note,

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including any accrued and unpaid interest, is convertible at \$0.10257 per share. The Company has granted the noteholder a security interest in all the Company's assets.

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 note. 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 \$33,991 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 note. The debt discount attributed to the beneficial conversion feature is amortized over the convertible note's maturity period (one year) as interest expense.

In connection with the issuance of the note, the Company issued non-detachable warrants granting the holders the right to acquire 400,000 shares of the Company's common stock at \$0.50 per share. The warrants expire five years from the issuance. In accordance with Emerging Issues Task Force Issue 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments (EITF 0027), the Company recognized the value attributable to the warrants in the amount of \$15,920 to additional paid in capital and a discount against the convertible note. The Company valued the warrants in accordance with EITF 00-27 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 4.64%, a dividend yield of 0%, and

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NOTE D PRIVATE PLACEMENT OF CONVERTIBLE NOTES (continued)

volatility of 72.84%. The debt discount attributed to the value of the warrants issued is amortized over the convertible note's maturity period (one year) as interest expense.

The Company recorded the intrinsic value of the embedded beneficial conversion feature (\$33,991) and warrants (\$15,920) to debt discount, aggregating \$49,911, which will be amortized to interest expense over the term of the Notes. Amortization of \$12,580 was recorded for the three months ended December 31, 2007.

10% Secured Convertible Promissory Note dated August 8, 2007

On August 8, 2007, the Company issued a \$100,000 convertible promissory note due August 8, 2008 with interest at 10% per annum due upon maturity. The note is convertible at any time prior to maturity, at the holder's option, at \$0.50 per share. At maturity, the note, including any accrued and unpaid interest, is convertible at \$0.09627 per share. The Company has granted the noteholder a security interest in all the Company's assets.

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 note. 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 \$24,643 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 note. The debt discount attributed to the beneficial conversion feature is amortized over the convertible note's maturity period (one year) as interest expense.

In connection with the issuance of the note, the Company issued non-detachable warrants granting the holder the right to acquire 200,000 shares of the Company's common stock at \$0.50 per share. The warrants expire five years from the issuance. In accordance with Emerging Issues Task Force Issue 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments (EITF 0027), the Company recognized the value attributable to the warrants in the amount of \$7,960 to additional paid in capital and a discount against the convertible note. The Company

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valued the warrants in accordance with EITF 00-27 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 4.69%, a dividend yield of 0%, and volatility of 92.71%. The debt discount attributed to the value of the warrants issued is amortized over the convertible note's maturity period (one year) as interest expense.

The Company recorded the intrinsic value of the embedded beneficial conversion feature (\$24,643) and warrants (\$7,960) to debt discount, aggregating \$32,603, which will be amortized to interest expense over the term of the Notes. Amortization of \$8,218 was recorded for the three months ended December 31, 2007.

10% Secured Convertible Promissory Note dated September 28, 2007

On September 8, 2007, the Company issued a \$300,000 related party convertible promissory note due September 8, 2008 with interest at 10% per annum due upon maturity. The note is convertible at any time prior to maturity, at the holder's option, at \$0.50 per share. At maturity, the note, including any accrued and unpaid interest, is convertible at \$0.06643 per share. The Company has granted the noteholder a security interest in all the Company's assets.

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 note. 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 \$151,604 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 note. The debt discount attributed to the beneficial conversion feature is amortized over the convertible note's maturity period (one year) as interest expense.

In connection with the issuance of the note, the Company issued non-detachable warrants granting the holder the right to acquire 600,000 shares of the Company's common stock at \$0.50 per share. The warrants expire five years

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Applied DNA Sciences, Inc. Notes To Consolidated Financial Statements December 31, 2007 (unaudited)

NOTE D PRIVATE PLACEMENT OF CONVERTIBLE NOTES (continued)

from the issuance. In accordance with Emerging Issues Task Force Issue 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments (EITF 0027), the Company recognized the value attributable to the warrants in the amount of \$32,580 to additional paid in capital and a discount against the convertible note. The Company valued the warrants in accordance with EITF 00-27 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 4.23%, a dividend yield of 0%, and volatility of 102.39%. The debt discount attributed to the value of the warrants issued is amortized over the convertible note's maturity period (one year) as interest expense.

The Company recorded the intrinsic value of the embedded beneficial conversion feature (\$151,604) and warrants (\$32,580) to debt discount, aggregating \$184,184, which will be amortized to interest expense over the term of the Notes. Amortization of \$46,425 was recorded for the three months ended December 31, 2007.

10% Secured Convertible Promissory Notes dated October 4, 2007

On October 4, 2007, the Company issued \$550,000 principal amount convertible promissory notes due October 4, 2008 with interest at 10% per annum due upon maturity. The notes are convertible at any time prior to maturity, at the option of the holders into shares of our common stock at a price equal to the greater of (i) 50% of the average price of our common stock for the ten trading days prior to the date of the notice of conversion or (ii) at a weighted average of \$0.070229 per share. At maturity, the notes, including any accrued and unpaid interest, are

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convertible at a weighted average of \$0.070229 per share. The Company has granted the noteholders a security interest in all the Company's assets.

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 \$234,308 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. The debt discount attributed to the beneficial conversion feature is amortized over the convertible notes' maturity period (one year) as interest expense.

In connection with the issuance of the notes, the Company issued non-detachable warrants granting the holders the right to acquire 1,100,000 shares of the Company's common stock at \$0.50 per share. The warrants expire five years from the issuance. In accordance with Emerging Issues Task Force Issue 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments (EITF 0027), the Company recognized the value attributable to the warrants in the amount of \$59,840 to additional paid in capital and a discount against the convertible notes. The Company valued the warrants in accordance with EITF 00-27 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 4.22%, a dividend yield of 0%, and volatility of 103.81%. The debt discount attributed to the value of the warrants issued is amortized over the convertible notes' maturity period (one year) as interest expense.

The Company recorded the intrinsic value of the embedded beneficial conversion feature (\$234,308) and warrants (\$59,840) to debt discount, aggregating \$294,148, which will be amortized to interest expense over the term of the Notes. Amortization of \$70,918 was recorded for the three months ended December 31, 2007.

10% Secured Convertible Promissory Notes dated October 30, 2007

On October 30, 2007, the Company issued \$650,000 principal amount convertible promissory notes due October 30, 2008 with interest at 10% per annum due upon maturity. The notes are convertible at any time prior to maturity, at the option of the holders, into shares of our common stock at a price equal to the greater of (i) 50% of the average price of our common stock for the ten trading days prior to the date of the notice of conversion or (ii) at a weighted average of \$0.104750019 per share. At maturity, the notes, including any accrued and unpaid interest, are convertible at a weighted average of \$0.10590112 per share. The Company has granted the noteholders a security interest in all the Company's assets.

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NOTE D PRIVATE PLACEMENT OF CONVERTIBLE NOTES (continued)

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 \$271,838 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. The debt discount attributed to the beneficial conversion feature is amortized over the convertible notes' maturity period (one year) as interest expense.

In connection with the issuance of the notes, the Company issued non-detachable warrants granting the holders the right to acquire 1,300,000 shares of the Company's common stock at \$0.50 per share. The warrants expire five years from the issuance. In accordance with Emerging Issues Task Force Issue 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments (EITF 0027), the Company recognized the value attributable to the warrants in the amount of \$126,100 to additional paid in capital and a discount against the convertible notes. The

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Company valued the warrants in accordance with EITF 00-27 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 3.85%, a dividend yield of 0%, and volatility of 108.66%. The debt discount attributed to the value of the warrants issued is amortized over the convertible notes' maturity period (one year) as interest expense.

On November 19, 2007, a noteholder elected to convert \$50,000 10% Convertible Promissory Note and accrued interest of \$274 to 479,942 shares of the Company's common stock.

The Company recorded the intrinsic value of the embedded beneficial conversion feature (\$271,838) and warrants (\$126,100) to debt discount, aggregating \$397,938, which will be amortized to interest expense over the term of the Notes. Amortization of \$93,578 was recorded for the three months ended December 31, 2007 inclusive of the write off of the unamortized debt discount relating to the converted note described above.

10% Secured Convertible Promissory Notes dated November 29, 2007

On November 29, 2007, the Company issued \$1,000,000 principal amount convertible promissory notes due November 29, 2008 with interest at 10% per annum due upon maturity. The notes are convertible at any time prior to maturity, at the option of the holders, into shares of our common stock at a price equal to the greater of (i) 50% of the average price of our common stock for the ten trading days prior to the date of the notice of conversion or (ii) at \$0.094431519 per share. At maturity, the notes, including any accrued and unpaid interest, are convertible at a weighted average of \$0.094431519 per share. The Company has granted the noteholders a security interest in all the Company's assets.

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 \$376,659 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. The debt discount attributed to the beneficial conversion feature is amortized over the convertible notes' maturity period (one year) as interest expense.

In connection with the issuance of the notes the Company issued non-detachable warrants granting the holders the right to acquire 2,000,000 shares of the Company's common stock at \$0.50 per share. The warrants expire five years from the issuance. In accordance with Emerging Issues Task Force Issue 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments (EITF 0027), the Company recognized the value attributable to the warrants in the amount of \$157,200 to additional paid in capital and a discount against the convertible notes. The Company

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Applied DNA Sciences, Inc.
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NOTE D PRIVATE PLACEMENT OF CONVERTIBLE NOTES (continued)

valued the warrants in accordance with EITF 00-27 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 3.42%, a dividend yield of 0%, and volatility of 106.15%. The debt discount attributed to the value of the warrants issued is amortized over the convertible notes' maturity period (one year) as interest expense.

The Company recorded the intrinsic value of the embedded beneficial conversion feature (\$376,659) and warrants (\$157,200) to debt discount, aggregating \$533,859, which will be amortized to interest expense over the term of the Notes. Amortization of \$46,804 was recorded for the three months ended December 31, 2007.

10% Secured Convertible Promissory Note dated December 20, 2007

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On December 20, 2007, the Company issued \$450,000 principal amount convertible promissory notes due December 20, 2008 with interest at 10% per annum due upon maturity. The notes are convertible at any time prior to maturity, at the option of the holders, into shares of our common stock at a price equal to the greater of (i) 50% of the average price of our common stock for the ten trading days prior to the date of the notice of conversion or (ii) at \$0.074766323 per share. At maturity, the notes, including any accrued and unpaid interest, are convertible at a weighted average of \$0.074766323 per share. The Company has granted the noteholders a security interest in all the Company's assets.

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 \$151,875 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. The debt discount attributed to the beneficial conversion feature is amortized over the convertible notes' maturity period (one year) as interest expense.

In connection with the issuance of the notes, the Company issued non-detachable warrants granting the holders the right to acquire 900,000 shares of the Company's common stock at \$0.50 per share. The warrants expire five years from the issuance. In accordance with Emerging Issues Task Force Issue 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments (EITF 0027), the Company recognized the value attributable to the warrants in the amount of \$49,590 to additional paid in capital and a discount against the convertible notes. The Company valued the warrants in accordance with EITF 00-27 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 3.45%, a dividend yield of 0%, and volatility of 104.51%. The debt discount attributed to the value of the warrants issued is amortized over the convertible notes' maturity period (one year) as interest expense.

The Company recorded the intrinsic value of the embedded beneficial conversion feature (\$151,875) and warrants (\$49,590) to debt discount, aggregating \$201,465, which will be amortized to interest expense over the term of the Notes. Amortization of \$6,072 was recorded for the three months ended December 31, 2007.

NOTE E - RELATED PARTY TRANSACTIONS

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 existed. There were no advances due at December 31, 2007.

During the years ended September 30, 2007 and 2006, the Company's Chief Executive Officer, or entities controlled by the Company's Chief Executive Officer, has advanced funds to the Company in the form of convertible promissory notes for working capital purposes (see Note D).

During the three months ended December 31, 2007, the Company had sales of \$18,063 (or 14.7% of total sales) to an entity whereby the Company's Chief Executive Officer is the President.

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Applied DNA Sciences, Inc.
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NOTE F - CAPITAL STOCK

The Company is authorized to issue 410,000,000 shares of common stock, with a \$0.001 par value per share as the result of a shareholder meeting conducted on May 16, 2007. Prior to the May 16, 2007 share increase, the Company was authorized to issue 250,000,000 shares of common stock with a \$0.001 par value per share. In addition, the Company is authorized to issue 10,000,000 shares of preferred stock with a \$0.0001 par value 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 Three Months Ended December 31, 2007:

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In November 2007, the Company issued 1,000,000 shares of common stock in exchange for consulting services. The Company valued the shares at \$0.14 per share for a total of \$140,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In November 2007, the Company issued 479,942 shares of common stock in exchange for secured convertible promissory notes of \$50,000 and related accrued interest.

In December 2007, the Company issued 9,000,000 shares of common stock in exchange for consulting services. The Company valued the shares at \$0.10 per share for a total of \$900,000, 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 following table summarizes the changes in warrants outstanding and the related prices for the shares of the Company's common stock issued to non-employees 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.

Exercise Prices	Number Outstanding	Warrants Outstanding Remaining Contractual	Weighted Average Exercise Price	Weighted Average Exercisable	Exercisable Weighted Average Exercise Price
		Life (Years)			
\$0.09	18,900,000	3.67	\$ 0.09	18,900,000	\$ 0.09
\$0.10	105,464	1.54	\$ 0.10	105,464	\$ 0.10
\$0.20	5,000	.88	\$ 0.20	5,000	\$ 0.20
\$0.50	23,950,000	3.66	\$ 0.50	18,650,000	\$ 0.50
\$0.55	9,000,000	0.46	\$ 0.55	9,000,000	\$ 0.55
\$0.60	8,847,000	1.42	\$ 0.60	8,847,000	\$ 0.60
\$0.70	200,000	1.03	\$ 0.70	200,000	\$ 0.70
\$0.75	14,797,000	2.10	\$ 0.75	14,797,000	\$ 0.75
	75,804,464			70,504,464	

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Applied DNA Sciences, Inc.
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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, 2006	72,369,464	.48
Granted	11,200,000	0.18

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Exercised	-	-
Canceled or expired	(1,135,000)	(0.70)
Outstanding at September 30, 2007	82,434,464	0.43
Granted	5,300,000	0.50
Exercised	-	-
Canceled or expired	(11,930,000)	(0.26)
Balance, December 31, 2007	75,804,464	\$0.46

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			
		Weighted			
		Average			
		Remaining	Weighted	Weighted	
		Contractual	Average	Average	
Exercise	Number	Life	Exercise	Number	Exercise
Prices	Outstanding	(Years)	Price	Exercisable	Price
\$0.68	3,660,000	3.75	\$0.68	3,660,000	\$0.68
0.09	2,000,000	3.91	0.09	2,000,000	0.09
	5,660,000			5,660,000	0.47

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

	Number of	Weighted Average
	Shares	Exercise Price Per Share
Outstanding at October 1, 2006	5,660,000	\$0.47
Granted	-	-
Exercised	-	-
Cancelled or expired	-	-
Outstanding at September 30, 2007	5,660,000	\$0.47
Granted	-	-
Exercised	-	-
Canceled or expired	-	-
Outstanding at December 31, 2007	5,660,000	\$0.47

The Company did not grant any employee options during the three months ended December 31, 2007.

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NOTE H- 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 October 2008. In November 2005, the Company vacated the Los Angeles facility to relocate to the current Stony Brook, New York address. Total lease rental expense for the three months ended December 31, 2007 was \$18,083.

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.

Litigation

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.

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. 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. 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. As of December 31, 2007, the Company has not had a registration statement declared effective relating to the common stock underlying the Notes and related warrants and in accordance with EITF 00-19-2, the Company evaluated the likelihood of achieving registration statement effectiveness. The Company has charged to operations penalties of \$7,725,585 for the year ended September 30, 2007 and has accrued \$11,750,941 as of December 31, 2007 to account for these potential liquidated damages until the expected effectiveness of the registration statement is achieved (see Note C).

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, and engaged 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. The members of our management who effectuated the stock issuances that are being examined in the investigation no longer work for us. In the event that any of the exemptions from registration with respect to the issuance of

Applied DNA Sciences, Inc.
Notes To Consolidated Financial Statements
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(unaudited)

NOTE H – COMMITMENTS AND CONTINGENCIES(continued)

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. Since our voluntary report of the findings of our internal investigation to the SEC on April 26, 2006, we have received no communication from the SEC or any third party with respect to this matter. There can be no assurance that litigation asserting such claims will not be initiated, or that the Company would prevail in any such litigation.

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 I - 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 three months ended December 31, 2007, the Company incurred a loss of \$2,132,744. 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 and marketing 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 (see Note J).

NOTE J SUBSEQUENT EVENTS

In January 2008, the Company issued an aggregate of \$450,000 10% Secured Convertible Promissory Notes with an automatic conversion one year from issuance at a weighted average conversion price of \$0.073512803. Additionally, the notes are convertible into shares of the Company's common stock at any time, at the option of the noteholder, prior to the automatic conversion date, at the greater of (i) 50% of the average price of the Company's common stock for the ten trading days prior to the date of the notice of conversion and (ii) the automatic conversion price.

In conjunction with the issuance of the 10% Secured Convertible Promissory Notes, the Company issued 900,000 warrants to purchase its common stock for cash or on a cashless basis at \$0.50 per share exercisable over four years with certain redemption features.

Item 2. Management's Discussion and Analysis

The following discussion should be read in conjunction with our Consolidated Financial Statements and Notes thereto, included elsewhere within this report. This quarterly report contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act, including statements using terminology such as can, may, believe, designated to, will, expect, plan, 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:

- discuss our future expectations;
- contain projections of our future results of operations or of our financial condition; and
- 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 report. 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:

- assure manufacturers, suppliers, distributors, retailers and end-users that their products are authentic and can be forensically authenticated;
- integrate our SigNature DNA Markers with existing security solutions such as barcodes, radio frequency identification (RFID) tags, holograms, microchips and other securities measures; and
- 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 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:

- continuing to improve and customize our solution to meet our potential customers' needs;
- continuing to develop and enhance our existing DNA marker authentication technologies;
- expanding our customer base both domestically and abroad by targeting high volume markets; and
- 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,

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pharmaceuticals, and homeland security driven programs. We intend to pursue both domestic and international sales opportunities in each of these vertical markets.

We are currently being funded by proceeds from a private placement offerings, which have raised an aggregate of \$3,350,000 from June 2007 through the end of January 2008. We are currently seeking additional capital to sustain or expand our prototype and sample manufacturing, and sales and marketing activities, and to otherwise continue our business operations. 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 \$150,000 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

We currently have seven employees and three part-time employees. The 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 Securities and Exchange Commission (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:

- Equity issued with registration rights ;
- Revenue recognition;
- Allowance for doubtful accounts;
- Warrant liability; and
- Fair value of intangible assets.

Equity Issued with Registration Rights

In connection with the 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 in the past, and accordingly has been reflected between liabilities and equity in our previous consolidated balance sheet.

In September 2007, we exchanged our common stock for the remaining Secured Convertible Promissory Note that contained embedded derivatives such as certain conversion features, variable interest features, call options and default provisions.

The Company has an accumulative accrual of \$11,750,941 in liquidating damages in relationship to the previously outstanding convertible promissory notes and related warrants.

Revenue Recognition

Revenues are derived from research, development, qualification and production testing for certain commercial products.

Revenue from fixed price testing contracts is generally recorded upon completion of the contracts, which are generally short-term, or upon completion of identifiable contractual tasks. At the time the Company enters into a contract that includes multiple tasks, the Company estimates the amount of actual labor and other costs that will be required to complete each task based on historical experience. Revenues are recognized which provide for a profit margin relative to the testing performed. Revenue relative to each task and from contracts which are time and materials based is recorded as effort is expended. Billings in excess of amounts earned are deferred. Any anticipated losses on contracts are charged to income when identified. To the extent management does not accurately forecast the level of effort required to complete a contract, or individual tasks within a contract, and the Company is unable to negotiate additional billings with a customer for cost over-runs, the Company may incur losses on individual contracts. All selling, general and administrative costs are treated as period costs and expensed as incurred.

Allowance for Uncollectible Receivables

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. The Company uses a combination of write-off history, aging analysis and any specific known troubled accounts in determining the allowance. If the financial condition of customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required.

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's 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.

The identifiable intangible assets acquired and their carrying values at December 31, 2007 are:

Trade secrets and developed technologies (Weighted average life of 7 years)	\$9,430,900
Patents (Weighted average life of 5 years)	<u>34,257</u>
Total Amortized identifiable intangible assets-Gross carrying value:	\$9,465,157
Less:	
Accumulated Amortization	(2,165,986)
Impairment	<u>(5,655,011)</u>
Net:	\$1,644,160
Residual value:	\$ 0

Total amortization expense charged to operations for the three months ended December 31, 2007 was \$92,661. Amortization expense charged to operations for the three months ended December 31, 2006 was \$92,661.

Estimated amortization expense as of December 31, 2007 is as follows:

2008	\$277,982
2009	\$365,842
2010	\$363,792
2011	\$363,792
2012 and thereafter	\$272,752
Total	\$1,644,160

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.

Comparison of Results of Operations for the Three Months Ended December 31, 2007 and 2006

Revenues

During the year ended September 30, 2007, we transitioned from a development stage enterprise to an operating company. For the three months ended December 31, 2007, we generated \$123,167 in revenues from operations and our cost of sales for the three months ended December 31, 2007 was \$27,890, netting us a gross profit of \$95,277. For the three months ended December 31, 2006, we had no revenues or cost of sales.

Costs and Expenses

Selling, General and Administrative

Selling, general and administrative expenses decreased from \$2,054,455 for the three months ended December 31, 2006 to \$1,698,269 for the three months ended December 31, 2007. The decrease of \$356,186, or 17.3%, is primarily attributable to a decrease in cost incurred in connection with professional services.

Research and Development

Research and development expenses increased from \$29,306 for the three months ended December 31, 2006 to \$36,326 for the same period in 2007. The increase of \$7,020 is attributed to more research and development activity related to the recent development and feasibility study agreements than during the prior period.

Depreciation and Amortization

In the three months ended December 31, 2007, depreciation and amortization decreased by \$75 from \$107,879 to \$107,804 for the period compared to the same period in 2006. The decrease is attributable to the reduced depreciation of our property and equipment.

Total Operating Expenses

Total operating expenses decreased to \$1,842,399 from \$2,191,640, or a decrease of \$349,241 primarily attributable to a decrease in costs incurred in connection with professional services.

Other Income/Loss

Gain on reevaluation of debt derivative and warrant liability decreased by \$2,098,471 from a gain of \$2,098,471 million for the three months ended December 31, 2006 to \$0 for the three months ended December 31, 2007. In September 2007, we exchanged common stock for the remaining Secured Convertible Promissory Notes that contained embedded derivatives. As a result, we reclassified the warrant liabilities recorded in conjunction with the convertible promissory notes to equity as of the conversion date of the related debt.

Interest Expenses

Interest expense for the three months ended December 31, 2007 decreased by \$193,408 to \$385,622 from \$579,030 in the same period of 2006. The decrease in interest expense was due to the conversion into common stock in 2007 of the convertible notes issued in connection with financings affected in 2006.

Net Income (loss)

Net loss for the three months ended December 31, 2007 increased to \$2,132,744 from a net loss of \$671,222 in the prior period primarily attributable to the gain on reevaluation of debt derivative and warrant liability reported in 2006 compared to \$0 in 2007.

Biowell Agreement

In the first half of 2005, Biowell Technology, Inc. (Biowell) transferred substantially all of its 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 our existing license agreement and, on July 12, 2005, we entered into a license agreement with Biowell, under which we granted Biowell an exclusive license to sell, market, and sub-license certain of our products in Australia, certain countries in Asia and certain Middle Eastern countries. By letter dated November 1, 2007, we terminated Biowell's rights as licensee with respect to Australia, China and certain other countries in Asia because of Biowell's failure to pay us certain fees, payments or consideration in connection with the grant of the license. In addition, we terminated the exclusivity of the license with respect to certain Middle Eastern and other Asian countries because of Biowell's failure to meet certain minimum annual net sales in each of the various countries covered by the license.

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.

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

As of December 31, 2007, we had a working capital deficit of approximately \$13.674 million. For the three period ended December 31, 2007, we generated a net cash flow deficit from operating activities of \$1.427 million consisting primarily of year to date losses of \$2.133 million.

Non-cash adjustments included \$492,443 in depreciation and amortization charges and common stock issued for services provided of \$1,040,000. Additionally,

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we had a net decrease in current assets of \$29,368 and a net decrease in current liabilities of \$855,607. Cash used in investing activities totaled \$94,508, which was utilized for acquisition of property and equipment of \$5,492 and reduction in cash held in escrow of \$100,000. We met our cash flow needs by issuance of convertible notes of \$2,152,500, net, for the three months ended December 31, 2007.

We expect capital expenditures to be less than \$200,000 in fiscal 2008. Our primary investments will be in laboratory equipment to support prototyping and our authentication services.

Debt and Equity Financing Transactions

In fiscal 2006, we completed three 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 Dr. Hayward, a director, our President and 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 Dr. Hayward, a director, our President and 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 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 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* consisted 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*.

In fiscal 2007, we issued sold an aggregate principal amount of \$850,000 in secured convertible promissory notes bearing interest at 10% per annum and warrants to purchase an aggregate of 1,700,000 shares of our common stock to Dr. James A. Hayward, a director, the Chairman of the Board of Directors, our President and Chief Executive Officer, as follows:

On April 23, 2007, we issued and sold a \$100,000 principal amount secured promissory note bearing interest at a rate of 10% per annum and a warrant to purchase 200,000 shares of our common stock. The promissory note and accrued but unpaid interest thereon are convertible into shares of common stock of the Company at a price of \$0.50 per share by the holder of the promissory note at any time from April 23, 2007 through April 22, 2008, and shall automatically convert on April 22, 2008 at a conversion price of \$0.15. The warrant is exercisable for a four-year period commencing on April 23, 2008, and expiring on April 22, 2012, at a price of \$0.50 per share. The warrant may be redeemed at our option at a redemption price of \$0.001 upon the earlier of (i) April 22, 2010, and (ii) the date our common stock has traded on The Over the Counter Bulletin Board at or above \$1.00 per share for 20 consecutive trading days.

On June 30, 2007, we issued and sold a \$250,000 principal amount secured promissory note bearing interest at a rate of 10% per annum and a warrant to purchase 500,000 shares of our common stock. The promissory note and accrued but unpaid interest thereon are convertible into shares of our common stock at a price of \$0.50 per share by the holder of the promissory note at any time from June 30, 2007 through June 29, 2008, and shall automatically convert on June 30, 2008 at a conversion price of \$0.087732076 per share, which is equal to a 20% discount to the average volume, weighted average price of our common stock for the ten trading days prior to issuance. The warrant is exercisable for a four-year period commencing on June 30, 2008, and expiring on June 29, 2012, at a price of \$0.50 per share.

On July 30, 2007, we issued and sold a \$200,000 principal amount secured promissory note bearing interest at a rate of 10% per annum and a warrant to purchase 400,000 shares of our common stock. The promissory note and accrued but unpaid interest thereon are convertible into shares of our common stock at a price of \$0.50 per share by the holder of the promissory note at any time from July 30, 2007 through July 29, 2008, and shall automatically convert on July 30, 2008 at a conversion price of \$0.102568072 per share, which is equal to a 20% discount to the average volume, weighted average price of our common stock for the ten trading days prior to issuance. The warrant is exercisable for a four-year period commencing on July 30, 2008, and expiring on July 29, 2012, at a price of \$0.50 per share.

On September 28, 2007, we issued and sold a \$300,000 principal amount secured promissory note bearing interest at a rate of 10% per annum and a warrant to purchase 600,000 shares of our common stock. The promissory note and accrued but unpaid interest thereon are convertible into shares of our common stock at a price of \$0.50 per share by the holder of the promissory note at any time from September 28, 2007 through September 27, 2008, and shall automatically convert on September 28, 2008 at a conversion price of \$0.066429851 per share, which is equal to a 20% discount to the average volume, weighted average price of our common stock for the ten trading days prior to issuance. The warrant is exercisable for a four-year period commencing on September 28, 2008, and expiring on September 27, 2012, at a price of \$0.50 per share.

In addition, on June 27, 2007, we completed a private placement offering of convertible debt and associated warrants in which we issued and sold to certain investors an aggregate of 3 units of our securities, each unit consisting of (i) a \$50,000 Principal Amount of 10% Secured Convertible Promissory Note and (ii) warrants to purchase 100,000 shares of our common stock. The notes and accrued but unpaid interest thereon are convertible into shares of our common stock at a price of \$0.50 per share by the holders of the notes at any time from June 27, 2007 to June 26, 2008, and shall automatically convert at \$0.15 per share on June 27, 2008. At any time prior to conversion, we have the right to prepay the notes and accrued but unpaid interest thereon upon 3 days notice (during which period the holders can elect to convert the notes). The warrants are exercisable for a four year period commencing on June 27, 2008, and expiring on June 26, 2012, at a price of \$0.50 per share.

From the beginning of October through December 31 2007, we issued and sold to investors an aggregate of \$2,650,000 10% Secured Convertible Promissory Notes with an automatic conversion one year from issuance at a conversion price which is equal to a discount to the average volume, weighted average price of our common stock for the ten trading days prior to issuance. The notes are convertible into shares of the Company's common stock at any time, at the option of the noteholder, prior to automatic conversion date, at the greater of (i) 50% of the average price of the Company's common stock for the ten trading days prior to the date of the notice of conversion and (ii) the automatic conversion price. In conjunction with the issuance and sale of the 10% Secured Convertible Promissory Notes, we issued warrants to purchase 5,300,000 shares of our common stock for cash or on cashless basis at \$0.50 per share exercisable over four years with certain redemption features.

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 currently require additional financing in order to meet our current and projected cash flow deficits from operations and development. We have sufficient funds to conduct our operations for approximately seven months. We presently do not have any available credit, bank financing or other readily available external sources of liquidity. 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, a downturn in the U.S. or global stock and debt markets and other reasons could make it more difficult to obtain financing through the issuance of equity securities or borrowing. Further, if we issue additional equity or convertible 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, 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 14, 2008, 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.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Inflation

The effect of inflation on our revenue and operating results was not significant.

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 14, 2008, 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.

RISK FACTORS

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:

If We Are Unable to Obtain Additional Financing Our Business Operations Will be 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 September 2008. 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.

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 \$13.3 million for the year ended September 30, 2007 and \$2.4 million for the year ended September 30, 2006. For the three months ended December 31, 2007, we incurred a net loss from operations of \$2,132,744. 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 that moved 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.

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 14, 2008, our independent auditors stated that our financial statements for the year ended September 30, 2007 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 incurring net losses of \$13.3 million for the year ended September 30, 2007. 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.

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 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 have transitioned this year 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 Are Obligated to Pay Liquidated Damages As a Result of Our Failure to Have the Registration Statement on Form SB-2 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 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 December 31, 2007 we have accrued approximately \$11.75 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.

We initially filed our registration statement on Form SB-2 with the SEC on February 15, 2005. We filed Amendment No.8 to the Form SB-2 on November 13, 2006 and the SEC's review and comment process is continuing. We can give no estimate as to when the registration statement will be declared effective. Our failure to have the registration statement declared effective has and may continue to adversely impact our ability to secure financing.

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:

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

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 of Dr. James A. Hayward, one of our directors, our President and 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., ID Global, Informium AG, Inksure Technologies, Kodak, L-1 Identity Solutions, Manakoa, SmartWater Technology, Inc., Sun Chemical Corp, Tracetag and Warnex.

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

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

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:

- operations and financial systems;
- procedures and controls; and
- 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:

- difficulties in staffing, managing and integrating international operations due to language, cultural or other differences;
- different or conflicting regulatory or legal requirements;
- foreign currency fluctuations; and
- 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.

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 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 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.

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 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 December 31, 2007, this could result in a significant decrease in our liquidity or assets, which could result in the reduction or termination of our business.

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 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. Since our voluntary report of the findings of our internal investigation to the SEC on April 26, 2006, we have received no communication from the SEC or any third party with respect to this matter. 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 February 11, 2008, we had 190,761,603 shares of common stock issued and outstanding and outstanding options and warrants to purchase 81,464,464 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 or Section 15(d) 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 six years, however, there can be no assurance that in the future we will always be current in our reporting requirements.

We May Not Be Able to Implement Section 404 of the Sarbanes-Oxley Act of 2002 on a Timely Basis.

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The SEC, as directed by Section 404 of the Sarbanes-Oxley Act, adopted rules generally requiring each public company to include a report of management on the company's internal controls over financial reporting in its annual report on Form 10-KSB that contains an assessment by management of the effectiveness of the company's internal controls over financial reporting. This requirement will first apply to our annual report on Form 10-KSB for the fiscal year ending September 30, 2008. Under current rules, commencing with our annual report for the fiscal year ending September 30, 2009 our independent registered accounting firm must attest to and report on management's assessment of the effectiveness of our internal controls over financial reporting.

We have not yet developed a Section 404 implementation plan. We have in the past discovered, and may in the future discover, areas of our internal controls that need improvement. How companies should be implementing these new requirements including internal control reforms to comply with Section 404's requirements and how independent auditors will apply these requirements and test companies' internal controls, is still reasonably uncertain.

We expect that we will need to hire and/or engage additional personnel and incur incremental costs in order to complete the work required by Section 404. We may not be able to complete a Section 404 plan on a timely basis. Additionally, upon completion of a Section 404 plan, we may not be able to conclude that our internal controls are effective, or in the event that we conclude that our internal controls are effective, our independent accountants may disagree with our assessment and may issue a report that is qualified. Any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations.

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 15g-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:

- that a broker or dealer approve a person's account for transactions in penny stocks; and

- 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.

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

- obtain financial information and investment experience objectives of the person; and

- 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.

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:

- sets forth the basis on which the broker or dealer made the suitability determination; and

- 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.

Item 3. Controls and Procedures

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a) *Evaluation of Disclosure Controls and Procedures:* As of December 31, 2007, our management carried out an evaluation, under the supervision of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's system of disclosure controls and procedures pursuant to the Exchange Act and Rules 13a-15(e) and 15d-15(e) promulgated thereunder. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the 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 under the Exchange Act.

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

- 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;
- accounting for and disclosing the fair value of shares issued to a former Director in exchange for previously incurred debt;
- accounting for and disclosing the fair value of warrants issued to note holders and consultants having registration rights; and
- 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 for the year ended September 30, 2005 and the quarterly unaudited data for the first three quarters of 2006 and all of 2005.

b) *Changes in internal control over financial reporting:* 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.

PART II. OTHER INFORMATION

Item 1. 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. et al. (Los Angeles Superior Court 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, and 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 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. We then agreed with Reep to consolidate this action with another matter pending in Los Angeles County Superior Court, captioned Applied DNA Sciences, Inc. v. Paul Reep, Case No. BC367661. Once this matter was consolidated with our affirmative lawsuit against Reep, we filed a demurrer to the first amended complaint. That demurrer resulted in several causes of action being dismissed. Reep then filed a Second Amended Complaint which asserts claims for breach of contract, declaratory relief, wrongful termination and defamation. We answered the Second Amended Complaint in November 2007 and denied all of the material allegations. The trial in this matter is currently set for July 2008. We intend to vigorously defend against the claims asserted against us.

Applied DNA Sciences, Inc. v. Paul Reep et al. (Los Angeles County Superior Court Case No. BC 367661):

We filed this action against the defendants, Paul Reep, Adrian Butash, John Barnett, Chanty Cheang, Jaime Cardona, Peter Brocklesby, Cheri Lu Brocklesby and Angela Wiggins on or about March 9, 2007. In this matter, we have asked the court to make a judicial determination that the defendants were unjustly enriched and breached fiduciary duties owed to the company. Specifically, we maintain that Reep and others

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knowingly accepted 1 million shares of unrestricted company stock even though they knew the Board of Directors had not approved the issuance and Peter Brocklesby could not authorize such an issuance without board approval. We have resolved its claims against all of the defendants except Reep and the Brocklesbys. After the resolution of the claims involving the other defendants, we agreed with Reep that this case should be consolidated with Paul Reep v. Applied DNA Sciences, Inc. et al, Los Angeles Superior Court Case No. BC345702. The trial in the consolidated matter is currently set for April 2008. We intend to vigorously prosecute our claims against Reep.

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.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Sales of Unregistered Securities

In the fiscal quarter ended December 31, 2007, we sold twenty-six and a half units at a price of \$100,000 per unit for sale to accredited investors, as defined in regulations promulgated under the Securities Act, for aggregate gross proceeds of \$2,650,000. Each unit consists of (i) a \$100,000 Principal Amount 10% Secured Convertible Promissory Note and (ii) a warrant to purchase 200,000 shares of our common stock.

The promissory notes and accrued but unpaid interest thereon automatically convert one year after issuance at a conversion price equal to a discount to the average volume, weighted average price of our common stock for the ten trading days prior to issuance, and are convertible into shares of our common stock at the option of the holder at any time prior to such automatic conversion at a price equal to the greater of (i) 50% of the average price of our common stock for the ten trading days prior to the date of the notice of conversion and (ii) the automatic conversion price. In addition, any time prior to conversion, we have the irrevocable right to repay the unpaid principal and accrued but unpaid interest under the notes on three days notice. The promissory notes bear interest at the rate of 10% per annum and are due and payable in full on the one year anniversary of their issuance.

The warrants are exercisable for cash or on a cashless basis for a period of four years commencing one year after issuance at a price of \$0.50 per share. Each warrant may be redeemed at our option at a redemption price of \$0.01 upon the earlier of (i) three years after the issuance, and (ii) the date our common stock has traded on The Over the Counter Bulletin Board at or above \$1.00 per share for 20 consecutive trading days.

In conjunction with the private placement of the units, we paid an aggregate of \$724,809 to the placement agent (of which amount \$327,500 was towards accrued liabilities).

We claim an exemption from the registration requirements of the Securities Act for the private placement of the units pursuant to Section 4(2) of the Securities Act because each of the units was made in a sale by the issuer not involving a public offering.

For additional information concerning our sales of unregistered securities during the period covered by this report, please refer to Note D to our Consolidated Financial Statements in Part I, Item 1 of this report, which is incorporated herein by reference.

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Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. 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
- 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
- 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
- 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 as an exhibit to the annual report
- 3.5 Articles of Amendment of Articles of Incorporation of Applied DNA Sciences, Inc. increasing the number of authorized shares of the company's common stock, filed as an exhibit to the annual report
- 3.6 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, 2005

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4.1 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 annual report

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- 10.1 Amendment to Engagement Letter, dated December 20, 2007, by and between Applied DNA Sciences, Inc. and ARjENT Limited, filed as an exhibit to the annual report
 - 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)

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

APPLIED DNA SCIENCES, INC.

Date: February 15, 2008

By: /s/ JAMES A. HAYWARD
James A. Hayward
Chief Executive Officer