APPLIED DNA SCIENCES INC
Form 10KSB/A
March 03, 2008

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

AMENDMENT NO. 1 TO FORM 10-KSB

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

For the Fiscal Year Ended September 30, 2006

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

For the Transition Period From _____ to _____

Commission File Number 002-90539

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

Nevada		59-2262718
(State or other jurisdiction of incorporation or organization)		(I.R.S. Employer Identification Number)
25 Health Sciences Drive, Suite 113 Stony Brook, New York (Address of principal executive office)	11790 (Postal Code)	(631) 444-6862 (Issuer's telephone number)

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

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

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

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

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

Indicate by checkmark whether the registrant is a shell company (as defined by Rule 12b−2 of the Exchange Act).

Yes o No x

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

The aggregate market value of the voting and non-voting common equity held by non−affiliates was $10.6 million, as computed by reference to the last sale price of the Company's Common Stock, as reported by the OTC Bulletin Board, on January 16, 2007.

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

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-KSB/A (this “Amendment”) amends the Annual Report of Applied DNA Sciences, Inc. (the “Company”) on Form 10-KSB for the year ended September 30, 2006, as filed with the Securities and change Commission on January 16, 2007 (the "Original Filing"). This Amendment is being filed for the purpose of clarifying the description of the accounting errors and related disclosures to the accompanying financial statements which gave rise to the restatement of the financial statements for the year ended September 30, 2005 and from September 16, 2002 (date of inception) through September 30, 2005 as described in Note M to the financial statements.
We have not updated the information contained herein for events occurring subsequent to January 16, 2007, the filing date of the Original Filing.

APPLIED DNA SCIENCES, INC.
AMENDMENT NO. 1 TO
FORM 10-KSB
For the Fiscal Year Ended September 30, 2006

PART I

Forward-looking Information

This Annual Report on Form 10-KSB (including the section regarding Management's Discussion and Analysis of Financial Condition and Results of Operations) contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, including statements using terminology such as “can”, “may”, “believe”, “designated to”, “will”, “expect”, “plan”, “anticipate”, “estimate”, “potential” or “continue”, or the negative thereof 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 prospectus. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to us as of the date thereof, and we assume no obligations to update any forward-looking statement or risk factor, unless we are required to do so by law.

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

ITEM 1. DESCRIPTION OF BUSINESS.

Corporate History

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

Overview

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

authenticate and identify counterfeit versions of such items enables companies and governments to detect, deter, interdict and prosecute counterfeiting enterprises and individuals.

Our SigNature Program enables ourpotential clients to cost-effectively:

- give assurance to 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.

Industry Background

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

Product counterfeiting and diversion particularly harms manufacturers of consumer products, especially for prestige and established brands, and the consumers who purchase them. For instance, according to the Gieschen Consultancy's 2005 Document, Product and Intellectual Property Security Report, or DOPIP, consumer products associated with worldwide counterfeit enforcement arrests, charges, convictions, sentences and civil litigation in 2005 amounted to around $1.5 billion. This total includes:

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

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

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

Governments are increasingly vulnerable to counterfeiting, terrorism and other security threats at least in part because currencies, identity and security cards and other official documents can be counterfeited with relative ease. For instance, the DOPIP valued 2005 seizures and losses associated with counterfeit currency at around $609 billion, and counterfeit identification at $124 million. Governments must also enforce the various anti-counterfeiting and

anti-piracy regimes of their respective jurisdictions which becomes increasingly difficult with the continued expansion of global trade.

The digital and recording media industry, including the segment that records computer software on compact discs, has long been a victim of piracy, or the production of illegal copies of genuine media or software, and the counterfeiting and distribution of imitation media or software. Compact discs, DVDs, videotapes, computer software and other digital and recording media that appears identical to genuine products are sold at substantial discounts by vendors at street and night markets, via mail order catalogs and on the internet at direct retail websites or at auction sites. In 2006 the Business Software Alliance ("BSA") reported that in 2005, the United Stateslost $6.9 billion as a result of software piracy. The BSA also estimated that 21 percent of software programs in the U.S.are unlicensed and that since January 1, 2000, the BSA has settled with 1,668 companies for a total of $81,821,895. In a white paper published in December 2005, the BSA and the IDC also reported that they found in a 2004 study that the world spent more than $59 billion for commercial packaged software. Yet, software worth over $90 billion was actually installed. In other words, for every two dollars worth of software purchased legitimately, one dollar was obtained illegally.

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

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

The Applied DNA Solution

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

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

We Believe Our SigNature DNA Markers Are Virtually Impossible to Copy

In creating unique SigNature DNA Markers, we use DNA segments from one or more botanical sources, rearrange them into unique encrypted sequences, and then implement one or more layers of anti-counterfeit techniques. Because the portion of DNA in a SigNature DNA Markerused to identify the marker is so minute, it cannot be detected unless it is replicated billions of times over, or amplified. This amplification can only be achieved by applying matching strands of DNA, or a primer, and PCR techniques to the SigNature DNA Marker. The sequence

of the relevant DNA in a SigNature DNA Marker must be known in order to manufacture the primer for that DNA. As a result, we believe the effortrequired to find, amplify, select and clone the relevantDNA in a SigNature DNA Marker would involve such enormous effort and expense that SigNature DNA Markers are virtually impossible to copy without our proprietary systems.

Simple and Rapid Authentication

With our advanced SigNature DNA Marker detection devices and PCR testing kits, any of our customers can quickly complete an on-site verification. When our SigNature DNA Encryption Detector pen comes in contact with our proprietary overt ink on a label or product package, a biochemical reaction triggers a reversible color change from blue to pink and back to blue. Testing of this color change can be repeated between 30 to 50 times. For forensic level authentication, our SigNature PCR testing kits can produce absolute authentication in less than 30 minutes using portable PCR machines.

Low Cost and High Accuracy

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

Easily Integrated with Other Anti-Counterfeit Technologies

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

Broad Applicability and Ingestible

Our SigNature DNA Markers can be embedded into almost any consumer product, and virtually any other item. For instance, the indelible SigNature DNA Ink we produce is safe to consumeand can be used in pharmaceutical drug tablets and capsules. Use of our SigNature DNA in ingestible products and drugs will require FDA approval. We have initiated a strategy to approach FDA in the first quarter of calendar year 2007.

Our Strategy

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

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

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

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

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

Target Potential High-Volume Markets

We will continue to focus our efforts on target vertical markets that are characterized by a high level of vulnerability to counterfeiting, product diversion, piracy, fraud, identity theft, and unauthorized intrusion into physical locations

and databases. Today our target markets include art and collectibles, fine wine, consumer products, digital and recording media, pharmaceuticals, and homeland security. If and when we have significantly penetrated these markets, we intend to expand into additional related high volume markets.

Pursue Strategic Acquisitions and Alliances

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

Target Markets

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

Art & Collectibles

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

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

Fine Wine

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

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

Consumer Products

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

Digital and Recording Media

The digital and recording media industry, including the segment that records computer software on compact discs, faces significant threats from piracy and the counterfeiting and distribution of imitation media or software. For instance, according to the BSA, in 2005 the United Stateslost $6.9 billion as a result of software piracy. OurSigNature DNA Markers can be embedded onto digital and recording media products, such as CDs, DVDs, videotapes and computer software, as well as the packaging of these products.

Pharmaceuticals

The pharmaceutical industry also faces major problems relative to counterfeit, diluted, or falsely labeled drugs that make their way through healthcare systems worldwide, posing a health threat to patients and a financial threat to drugmakers and distributors. As a result, the pharmaceutical industry and regulators are examining emerging anti-counterfeit technologies, including RFID tags and EPCs to help stem the wave of counterfeit drugs and better track legitimate drugs from manufacturing through the supply chain. Our SigNature DNA Markers can easily be embedded directly into pharmaceutical packaging or into RFID tags or EPCs attached to packaging, and since they are ingestible, may be applied as part of a unit dose. In its 2004 report "Combating Counterfeit Drugs,"the Food and Drug Administration ("FDA") noted that authentication technologies for pharmaceuticals (such as color-shifting inks, holograms, taggants, or chemical markers embedded in a drug or its label) have been sufficiently perfected that they can now serve as a critical component of a layered approach to control counterfeit drugs. FDA's 2004 Report acknowledged the importance of using one or more authentication technologies for drug products.

Homeland Security

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

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

Our Technology

Every living organism has a unique DNA code that determines the character and composition of its cells. The core technologies of our business allow us to use the DNA of everyday plants to mark objects in a unique manner that we believe can only be replicated at great expense, and then identify these objects by detecting the absence or presence of the DNA.

SigNature DNA Encryption

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

SigNature DNA Encapsulation

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

SigNature DNA Embedment

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

SigNature DNA Authentication

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

Products And Services

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

Creating a Customer or Product-Specific SigNature DNA Marker

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

Embedding the SigNature DNA Marker

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

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

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

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

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

SigNature DNA Detection and Product Authentication

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

Level 2 Forensic DNA Authentication: Our SigNature PCR Kits allow us or our customers to use a sample taken from the product or other item to be authenticated, and using our proprietary primers and PCR technology, determine the sequences of DNA included in the sample, and conclude whether it includes a specific SigNature DNA Marker. This more elaborate test generally requires about 30 minutes to complete. This authentication process provides absolute certainty about the presence or absence of specific types of a SigNature DNA Marker.

Sales and Marketing

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

Research and Development

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

Manufacturing

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

Competition

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

Some examples of competing security products include:

- Fingerprint scanner: a system that scans fingerprints before granting access to secure information or facilities;
- Voice recognition software: software that authenticates users based on individual vocal patterns;
- Cornea scanner: a scanner that scan the iris of a user's eye to compare with data in a computer database;
- Face scanner: a scanning system that use complex algorithms to distinguish one face from another;
- Integrated circuit chip & magnetic strips: integrated circuit chips that receive and, if authentic, send a correct electric signal back to the reader, and magnetic strips that contain information, both of which are common components of debit and credit cards;
- Optically variable microstructures: these include holograms, which display images in three dimensions and are generally difficult to reproduce using advanced color photocopiers and printing techniques, along with other devices with similar features;
-

- Elemental Taggants and Fluorescence: elemental taggants are various unique substances that can be used to mark products and other items, are revealed by techniques such as x-ray fluorescence; and,
- Radioactivity & Rare Molecules: radioactive substances or rare molecules which are uncommon and readily detected.

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

- 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.

PROPRIETARY RIGHTS

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

Patents Issued:

Patent Name	Patent No:	Assignee of Record	Dated Issued	Jurisdiction
Nucleic Acid as Marker for Product Anticounterfeiting and Identification	89108443	APDN (B.V.I.) Inc.	March 17,2000	Taiwan
Method of using ribonucleic acid as product antifake mark and for verification	00107580.2	Rixflex Holdings Limited (2)	February 2, 2005	China
EppenLocker (A Leakage-Prevention Apparatus of Microcentrifuge)	89204158	APDN (B.V.I.) Inc.	March 10, 2000	Taiwan
Multiple Tube Structure for Multiple PCR in a Closed Container	89210575	APDN (B.V.I.) Inc.	June 20, 2000	Taiwan
A Device for Multiple Polymerase Chain Reactions In a Closed Container and a Method of Using Thereof	89111477	APDN (B.V.I.) Inc.	June 12, 2000	Taiwan
Method for Mixing Nucleic Acid in Water Insoluble Media and Application Thereof	921221973	APDN (B.V.I.) Inc.	August 11, 2003	Taiwan
A Method of Utilizing Nucleic Acids as Markers for Product Anti-Counterfeit Labeling and Verification	US 7,115,301 B2	Rixflex Holdings Limited (2)	October 3, 2006	United States

Patents Pending:

Patent Name	Application No.	Filed in the Name of	Dated Filed	Jurisdiction
Method for Mixing Nucleic Acid in Water Insoluble Media and Application Thereof	2002-294229 03007023.9 10/645,602	Biowell (1) Rixflex Holdings Limited (2) Rixflex Holdings Limited (2)	August 31, 2002 March 27, 2003 August 22, 2003	Japan EU United States
Method of dissolving nucleic acid in water insoluble medium and its application	03155949.2	Rixflex Holdings Limited (2)	August 27, 2003	China
Novel nucleic acid based steganography system and application thereof	10/909,431	Rixflex Holdings Limited (2)	August 3, 2004	United States
Cryptic method of secret information carried in DNA molecule and it deencryption method A novel nucleic acid based steganography system and application thereof A novel method for coding based on nucleic acids and utility thereof A novel nucleic acid based steganography system and applications thereof	921221490 03127517.6 61387/2004 04018374.1 1-2004-00742 092819 PI20043145 2004-225987 P-00200400374 764/CHE/2004	APDN (B.V.I.) Inc. Biowell (1) Rixflex Holdings Limited (2) Rixflex Holdings Limited (2) Rixflex Holdings Limited (2) Rixflex Holdings Limited (2) Biowell (1) Rixflex Holdings Limited (2) Rixflex Holdings Limited (2) Rixflex Holdings Limited (2)	August 6, 2003 August 6, 2003 August 4, 2004 August 3, 2004 August 4, 2004 August 4, 2004 August 4, 2004 August 2, 2004 August 4, 2004 August 4, 2004	Taiwan China Korea EU Vietnam Thailand Malaysia Japan Indonesia India
Method for classifying group ID of shoppers and transferring the shopping discount to group development funds development Method For transferring feedback foundation capable of identifying multiple objects Method of Classifying Group ID of Shoppers and Transferring the Shopping Discount to Group Development Funds	92119302 03150071.4 PI20042889 092217 2004-200730	APDN (B.V.I.) Inc. Rixflex Holdings Limited (2) Rixflex Holdings Limited (2) Rixflex Holdings Limited (2) Biowell (1)	July 15, 2003 July 31, 2003 August 4, 2004 July 12, 2004 July 7, 2004	Taiwan China Malaysia Thailand Japan
System and Method for authenticating multiple components associated with a particular product.	11/437,265 PCT/US2006/019660	APDN (B.V.I.) Inc. APDN (B.V.I.) Inc.	May 19, 2005 May 19, 2006	US PCT

System and Method for Marking Textiles with Nucleic Acid	10/825,968	APDN (B.V.I.) Inc.	April 15, 2004	US
Method for Transferring Feedback-Foundation capable of identifying multiple objects	92119302 03150071.4	APDN (B.V.I.) Inc. Rixflex Holdings Limited(2)	July 15, 2003 July 31, 2003	Taiwan China

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

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

Trademarks Issued:

Trademark	Registration No:	Registered Owner	Registration Date	Jurisdiction
APPLIED DNA and model molecule design	846354	Applied DNA Sciences Inc.	August 13, 2004	Mexico
APPLIED DNA and model molecule design	846711	Applied DNA Sciences Inc.	August 16, 2004	Mexico
APPLIED DNA and model molecule design	3392818	Applied DNA Sciences Inc.	March 21, 2005	European Community
BIOWELL and Design	3,155,578	Rixflex Holdings Limited (1)	October 17, 2006	United States
BIOWELL and Design	2,675,941	Rixflex Holdings Limited (1)	January 21, 2003	United States
BIOWELL and Design	2,611,291	Rixflex Holdings Limited (1)	August 27, 2002	United States
BIOWELL and Design	4101159010000	Biowell (2)	May 4, 2005	South Korea
BIOWELL and Design	4,819,252	Rixflex Holdings Limited (1)	November 19, 2004	Japan

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

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

Trademarks Pending:

Trademark	Application No:	Owner	Filing Date	Jurisdiction
APPLIED DNA	76/549,861	APDN (B.V.I.) Inc.	September 22, 2003	United States
SIGNATURE	78/871,967		April 28, 2006	United States

APDN (B.V.I.)
Inc.

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

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

Strategic Alliances

Purchase of Intellectual Property and License Agreement with Biowell

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

improvements, modifications or alterations made by Biowell to the licensed products, the technologies underlying them, or the mode of using them, that are related to our business, and provides Biowell an exclusive license to any such improvements, modifications or alterations made by us.

Sub-License Agreement with G.A. Corporate Finance

In July of 2003, we, Biowell and G. A. Corporate Finance Ltd. entered into a Sub-License Agreement for the United Kingdom in exchange for $3 million. G. A. Corporate Finance Ltd. paid $25,000 upon its execution of the Agreement, and the remaining $2.975 million in the form of its interest bearing promissory note, payable in twenty (20) consecutive quarterly installments of principal and interest in the amount equal to the lesser of $185,937.50 or 35% of gross revenues for that quarter it generated from sales of certain of our products in the United Kingdom, due on the final day of each quarter. Due in part to our lack of marketable products during the first two years after the date of this agreement, G.A. Corporate Finance Ltd. has not generated any revenue from sales of our products in the United Kingdom, and so has never made any payments to us under its note. We are currently in negotiations with G.A. Corporate Finance Ltd. to either amend or terminate this agreement.

Employees

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

ITEM 2. DESCRIPTION OF PROPERTY.

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

ITEM 3. LEGAL PROCEEDINGS.

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

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

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

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

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

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

Plaintiffs John D. Barnett, Jr., Adrian Butash, Jaime A. Cardona, and Chanty Cheang, our former employees, filed suit against us, Applied DNA Operations Management, Inc., APDN (B.V.I.), Inc., Peter Brocklesby, James A. Hayward, and Jun-Jei Sheu in Los Angeles County Superior Court on April 17, 2006. The complaint alleges causes of action for breach of written contract, breach of oral contract, fraud, violations of the California Labor Code, and wrongful termination. The complaint seeks $159,000 (trebled to $477,000) in alleged unpaid salary, $546,000 in severance pay,

other unspecified compensatory and consequential damages, unspecified punitive damages, attorneys' fees and costs, and interest. With the exception of Peter Brocklesby, all defendants, including us, have answered the complaint. The trial date has been set for May 21, 2007.

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

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

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

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

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

None.

PART II

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

Market Information

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

The following table sets forth the quarterly quotes of high and low prices for our Common Stock on the OTC Bulletin Board during the fiscal years ended September 30, 2005 and September 30, 2006. In February of 2003, we changed our year end to September 30. We changed our fiscal year end in connection with a reverse merger we entered into in December 2002, in which the acquirer for accounting purposes had a fiscal year end of September 30. For ease of fiscal reporting, we adopted the same fiscal year end.

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

Holders

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

Dividends

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

Recent Sales of Unregistered Securities

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

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

On December 12, 2006 we issued 180,000 shares of common stock in exchange for our promissory note in principal amount of $410,429 and accrued interest thereon of $8,883. We valued the shares issued at $0.09 per share for a total of $16,200. This issuance is considered exempt under Section 3(a)(9) of the Securities Act of 1933.

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

The following discussion should be read in conjunction with our Consolidated Financial Statements and Notes thereto, included elsewhere within this report. The Annual Report on Form 10-KSB contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, including statements using terminology such as “can”, “may”, “believe”, “designated to”, “will”, “expect”, “plan”, “anticipate”, “estimate”, “potential” or 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 prospectus. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to us as of the date thereof, and we assume no obligations to update any forward-looking statement or risk factor, unless we are required to do so by law.

Introduction

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

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

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

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

Product Research and Development

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

Acquisition of Plant and Equipment and Other Assets

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

Number of Employees

From our inception through the period ended September 30, 2006, we have principally relied on the services of outside consultants for services. We currently have seven employees and two part-time employees. Specifically, the company expects to increase its staffing dedicated to sales, product prototyping, manufacturing of DNA markers and forensic authentication services. Expenses related to travel, marketing, salaries, and general overhead will be increased as necessary to support our growth in revenue. In order for us to attract and retain quality personnel, we anticipate we will have to offer competitive salaries to future employees. We anticipate that it may become desirable to add additional full and or part time employees to discharge certain critical functions during the next 12 months. This projected increase in personnel is dependent upon our ability to generate revenues and obtain sources of financing. There is no guarantee that we will be successful in raising the funds required or generating revenues sufficient to fund the projected increase in the number of employees. As we continue to expand, we will incur additional costs for personnel.

Critical Accounting Policies

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

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

The accounting policies identified as critical are as follows:

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

Equity Issued with Registration Rights

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

Warrant Liability

In connection with the placement of certain debt instruments, as described above, we issued freestanding warrants. Although the terms of the warrants do not provide for net-cash settlement, in certain circumstances, physical or net-share settlement is deemed to not be within our control and, accordingly, we are required to account for these freestanding warrants as a derivative financial instrument liability, rather than as shareholders' equity.

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

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

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

Fair Value of Intangible Assets

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

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

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

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

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

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

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

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

Use of Estimates

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

Restatement of Consolidated Financial Statements

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

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

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

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

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

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

Revenues

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

Costs and Expenses

Selling, General and Administrative

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

Research and Development

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

Depreciation and Amortization

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

Impairment of intangible asset(s)

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

Total Operating Expenses

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

Other Income/Loss

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

Interest Expenses

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

Net Income (loss)

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

Liquidity and Capital Resources

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

As of September 30, 2006, we had a working capital deficit of $4.6 million. For the year ended September 30, 2006, we generated a net cash flow deficit from operating activities of $2.8 million consisting primarily of year to date losses of $2.4 million. Non cash adjustments included $2.0 million in depreciation and amortization charges, $5.7 million in impairment charges, $3.0 million for options, warrants and common stock issued in exchange for services, $2.3 million in financing costs attributable to issuance of warrants and net change in net increase in current liabilities of $2.5 million net with a non cash adjustment of $16.8 million for income attributable to re-pricing of warrants and debt derivatives. Cash used in investing activities totaled $0.2 million, which was utilized for acquisition of property and equipment. Cash provided by financing activities for the year ended September 30, 2006 totaled $4.2 million consisting of proceeds from issuance of convertible debt.

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

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

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

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

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

In fiscal 2005, we completed two private placements of convertible debt and associated warrants. In November and December, 2004 we issued and sold $1.465 million in aggregate principal amount of promissory notes, convertible at $0.50 per share, and associated warrants to purchase up to 2,930,000 shares of our common stock, exercisable at $0.75 per share for three years from their date of issuance, to 13 investors (the "December 2004 Placement"). Each promissory note was automatically convertible into shares of our common stock at a price of $0.50 per share upon the closing of a subsequent private placement by us for at least $1 million. In January and February of 2005, we issued and sold $7.371 million in aggregate principal amount of 10% Secured Convertible Promissory Notes, convertible at $0.50 per share, and associated warrants to purchase up to 14,742,000 shares of our common stock, exercisable at $0.75 per share until five years from their date of issuance, to 61 investors (the "January and February 2005 Placement"). Upon the closing of the January and February 2005 Offering, the notes issued in the December 2004 Placement automatically converted into an aggregate of 2,930,000 shares of our common stock, and upon the filing of this registration statement on February 15, 2005, the notes issued in the January and February 2005 Placement automatically converted into an aggregate of 14,742,000 shares of our common stock. Additional private placements in fiscal 2005 raised $243,000. We also received proceeds of $60,000 from the exercise of a warrant to purchase 100,000 shares of our common stock in fiscal 2005. The $9.135 million in gross proceeds from these private placements and warrant exercises were used to fund commissions, fees and expenses associated with the placements, consultants and public reporting costs, salaries and wages, royalties, research and development, facility costs as well as general working capital needs. Since the conversion price of the notes issued in the November and December 2003, December 2004, December 2005 and the January and February 2005 placements were less than the market price of our common stock at the time these notes were issued, we recognized a charge relating to the beneficial conversion feature of these notes during the quarter in which they are issued.

In fiscal 2006, we completed three additional private placements of convertible debt and associated warrants. On November 3, 2005, we issued and sold a promissory note in the principal amount of $550,000 to Allied International Fund, Inc. ("Allied"). Allied in turn financed a portion of the making of this loan by borrowing $450,000 from certain persons, including $100,000 from James A. Hayward, a director and our Chief Executive Officer. The terms of the promissory note provided that we issue upon the funding of the note warrants to purchase 5,000,000 shares of our common stock at an exercise price of $0.50 per share to certain persons designated by Allied. On November 9, 2005,

we issued nine warrants to Allied and eight other persons to purchase an aggregate of 5,500,000 shares of our common stock at an exercise price of $0.50 per share. These warrants included a warrant to purchase 1,100,000 shares that was issued to James A. Hayward, a director and our Chief Executive Officer. We paid $55,000 in cash to VC Arjent, Ltd. for its services as the placement agent with respect to this placement. All principal and accrued but unpaid interest under the promissory note was paid in full shortly after the closing of and from the proceeds of a private placement we completed on March 8, 2006. On March 8, 2006, we issued and sold an aggregate of 30 units consisting of (i) a $50,000 principal amount secured convertible promissory note bearing interest at 10% per annum and convertible at $0.50 per share, and (ii) a warrant to purchase 100,000 shares of our common stock at an exercise price of $0.50 per share, for aggregate gross proceeds of $1.5 million. The units were sold pursuant to subscription agreements by and between each of the purchasers and Applied DNA Operations Management, Inc., a Nevada corporation and our wholly owned subsidiary (our "Subsidiary"). The $2.050 million in gross proceeds from these first two offerings were held by our Subsidiary for our benefit and used to fund commissions, fees and expenses associated with the placements, to repay the outstanding promissory note described above plus accrued interest thereunder, to fund financing fees, consultants and public reporting costs, salaries and wages, research and development, facility costs as well as and general working capital needs. On March 24, 2006, we commenced an offering (the "Offshore Offering") of up to 140 units, at a price of $50,000 per unit, for a maximum offering of $7 million for sale to "accredited investors" who are not "U.S. persons." The units being sold as part of the Offshore Offering consist of (i) a $50,000 principal amount secured convertible promissory note, and (ii) a warrant to purchase 100,000 shares of our common stock at a price of $0.50 per share. On May 2, 2006, we closed on the first tranche of the Offshore Offering in which we sold 20 units for aggregate gross proceeds of $1,000,000. We paid Arjent Limited $375,000 in commissions, fees and expenses from these gross proceeds. On June 15, 2006, we completed the second tranche of the Offshore Offering in which we sold 59 units for aggregate gross proceeds of $2,950,000. We paid Arjent Limited $442,500 in commissions, fees and expenses from these gross proceeds. Additionally, on July 10, 2006 we issued 2.4 million shares of our common stock to Arjent Limited at $0.001 per share as partial consideration for its services in connection with the Offshore Offering.

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

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

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

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

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Going Concern

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

FACTORS THAT COULD AFFECT FUTURE RESULTS

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

Risks Relating to Our Business:

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

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

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

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

If We Are Unable to Obtain Additional Financing Our Business Operations Will be Harmed or Discontinued, and If We Do Obtain Additional Financing Our Shareholders May Suffer Substantial Dilution.

We believe that our existing capital resources will enable us to fund our operations until approximately April, 2007. We believe we will be required to seek additional capital to sustain or expand our prototype and sample manufacturing, and sales and marketing activities, and to otherwise continue our business operations beyond that date. We have no commitments for any future funding, and may not be able to obtain additional financing or grants

on terms acceptable to us, if at all, in the future. If we are unable to obtain additional capital this would restrict our ability to grow and may require us to curtail or discontinue our business operations. Additionally, while a reduction in our business operations may prolong our ability to operate, that reduction would harm our ability to implement our business strategy. If we can obtain any equity financing, it may involve substantial dilution to our then existing shareholders.

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

In their report dated January 5, 2007, our independent auditors stated that our financial statements for the year ended September 30, 2006 were prepared assuming that we would continue as a going concern, and that they have substantial doubt about our ability to continue as a going concern. Our auditors' doubts are based on our incurring net losses of $92.3 million during the period from September 16, 2002 (date of inception) to September 30, 2006. We continue to experience net operating losses. Our ability to continue as a going concern is subject to our ability to generate a profit and/or obtain necessary funding from outside sources, including by the sale of our securities, obtaining loans from financial institutions, or obtaining grants from various organizations or governments, where possible. Our continued net operating losses and our auditors doubts increase the difficulty of our meeting such goals and our efforts to continue as a going concern may not prove successful.

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

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

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

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

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

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

- 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, and particularly Biowell, for the manufacture of some of our products to our specifications. The inability of a manufacturer to ship orders of such products in a timely manner or to meet our quality standards could cause us to miss the delivery date requirements of our customers for those items, which could result in cancellation of orders, refusal to accept deliveries or a reduction in purchase prices, any of which could harm our business by resulting in decreased revenues or net losses upon sales of products, if any sales could be made.

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

We compete with other companies for the production capacity of our manufacturers and import quota capacity. Some of these competitors have greater financial and other resources than we have, and thus may have an advantage in the competition for production and import quota capacity. If we experience a significant increase in demand, or if our existing manufacturers must be replaced, we will need to establish new relationships with another or multiple manufacturers. We cannot assure you that this additional third party manufacturing capacity will be available when required on terms that are acceptable to us or terms similar to those we have with our existing manufacturers, either from a production standpoint or a financial standpoint. We do not have long-term contracts with our manufacturers, and our manufacturers do not produce our products exclusively. Should we be forced to replace our manufacturers, we may experience an adverse financial impact, or an adverse 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 will believe is adequate, we may not be able to maintain this insurance at reasonable cost and on reasonable terms. We also cannot assure that this insurance, if obtained, will be adequate to protect us against a product liability claim, should one arise. In the event that a product liability claim is successfully brought against us, it could result in a significant decrease in our liquidity or assets, which could result in the reduction or termination of our business.

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

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

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

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

We paid liquidated damages in the form of common stock only for the period from June 15, 2005 to December 15, 2005, and only to persons who invested in the January and February, 2005 private placements. We believe that we

have no enforceable obligation to pay liquidated damages to holders of any shares we agreed to register under the registration rights agreement for periods after the first anniversary of the date of issuance of such shares, since they were eligible for resale under Rule 144 of the Securities Act during such periods, and such liquidated damages are grossly inconsistent with actual damages to such persons. Nonetheless, as of September 30, we have accrued $4.0 million in penalties representing further liquidated damages associated with our failure to have the registration statement declared effective by the deadline, and have included this amount in accounts payable and accrued expenses.

Matter Voluntarily Reported to the Securities and Exchange Commission

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

Risks Relating to Our Common Stock:

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

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

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

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

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

Stock.

The SEC has adopted Rule 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 7. FINANCIAL STATEMENTS.

APPLIED DNA SCIENCES, INC.

INDEX TO FINANCIAL STATEMENTS

RUSSELL BEDFORD STEFANOU MIRCHANDANI LLP
CERTIFIED PUBLIC ACCOUNTANTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

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

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

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

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

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

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

McLean, Virginia
January 5, 2007

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

ASSETS

Current assets:	
Cash	$ 1,225,304
Accounts receivable	9,631
Advances and other receivables	8,419
Prepaid expenses	106,667
Total current assets	1,350,021
Property and equipment-net of accumulated depreciation of $20,885 (Note A)	156,437
Other assets:	
Deposits	13,822
Capitalized finance costs-net of accumulated amortization of $636,013	1,049,087
Intangible assets:	
Patients, net of accumulated amortization of $18,593 (Note B)	15,663
Intellectual property, net of accumulated amortization of $7,339,100 (Note B)	2,091,800
Total Assets	$ 4,676,830

LIABILITIES AND DEFICIENCY IN STOCKHOLDERS' EQUITY

Current liabilities:	
Accounts payable and accrued liabilities (Note C)	$ 5,560,032
Convertible notes payable, net of unamortized discount (Note D)	3,761,771
Note payable-Related Party (Note E)	410,429
Total current liabilities	9,732,232
Debt derivative and warrant liability	4,530,795
Commitments and contingencies (Note K)	
Deficiency in Stockholders' Equity- (Note F)	
Preferred stock, par value $0.001 per share; 10,000,000 shares authorized; 60,000 issued and outstanding	6
Common stock, par value $0.001 per share; 250,000,000 shares authorized; 120,982,385 issued and outstanding	120,982
Additional paid in capital	82,627,606
Accumulated deficit	(92,334,791)
Total deficiency in stockholders' equity	(9,586,197)
Total liabilities and Deficiency in Stockholders' Equity	$ 4,676,830

See the accompanying notes to the consolidated financial statements