

Applied DNA Sciences – FQ4'17 Earnings Conference Call

Beth Jantzen, CPA, Chief Financial Officer

Thank you, Clay. Good afternoon everyone and thank you for joining us today.

Let me start with a review of our financial performance for our fourth fiscal quarter and full 2017 fiscal year, and provide you with an update on our cash reserves following our recently completed capital raise. Then Dr. James Hayward, our President and CEO will summarize the company's achievements in the year and outline key ongoing and future initiatives in fiscal 2018.

Summary of Quarterly and Annual Financial Results

Starting with the statement of operations, total revenues for the fiscal fourth quarter ended September 30, 2017 were \$1.1 million. This represents an approximate 30% decrease compared to \$1.6 million reported in the fiscal fourth quarter of 2016, and down approximately 36% compared to \$1.8 million of revenues in the third fiscal quarter of 2017. These decreases are primarily the result of the timing of shipments and the recognition of revenue related to our cotton contracts, as well the conclusion of the two government development contract awards that expired during Q4 of last fiscal year 2016.

For the fiscal year ended September 30, 2017, we recorded revenues of \$4.8 million, an increase of approximately \$600 thousand or 13% compared to revenues of \$4.2 million for the prior fiscal year. All though revenue for fiscal 2017 was not where we wanted, the year-over-year increase in revenues reflects our focus on revenue stream diversification as well as building our recurring revenue base over the year.

Product revenues declined approximately 38% for the fourth fiscal quarter of 2017 compared to the same quarter of 2016, and increased 47% for fiscal 2017 as compared to fiscal 2016. The increase year over year was driven primarily by the recognition of deferred revenue related to prior shipments of DNA concentrate for the marking of cotton. As a reminder, during Q3 of fiscal 2017 we entered into a new licensing agreement with Himatsingka. This new agreement, among other things, provides for 60 day payment terms as well as a greater gross margin than similar sales which took place under our previous arrangement for the sale of DNA concentrate to mark cotton.

Service revenues increased 13% and declined 38% during the fiscal fourth quarter and year ended September 30, 2017, respectively, as compared to the same periods in fiscal 2016. Service revenues increased in the fiscal fourth quarter due to an increase in feasibility studies, which Jim will discuss in more detail later. Service revenues declined in fiscal 2017 as compared to fiscal 2016 due to the conclusion of the two government contract awards last fiscal year, which expired during July and August 2016.

This was offset in part by a new 2-year government contract awarded in our fiscal third quarter, for a total net decrease in revenue from government contract awards of approximately \$800 thousand for the year, offset by an increase in feasibility projects during fiscal 2017.

Gross margin as a percentage of product revenue in our fiscal fourth quarter was flat at 68% as compared to the year-ago period.

Total operating expenses remained fairly constant at \$3.7 million for the quarter ended September 30, 2017, compared with \$3.6 million for the same period in the prior fiscal year.

For the fiscal year ended September 30, 2017, total operating expenses increased 8% compared to the prior fiscal year from \$15.2 million to \$16.5 million. This increase reflects higher stock-based compensation expense of approximately \$1.2 million, an increase in bad debt expense of approximately \$307 thousand and an increase in depreciation and amortization of approximately \$180 thousand, all of which are non-cash expenses. These increases were offset by an approximate \$1.4 million decrease in research and development expenses.

EBITDA

For the fourth fiscal quarter of 2017, adjusted EBITDA was a negative \$1.7 million as compared to a negative \$1.5 million in the third fiscal quarter of 2017 and a negative \$1.7 million for Q4 2016. Year-over-year, EBITDA

improved by approximately \$1.0 million to a negative \$8.3 million from a negative \$9.2 million in the prior fiscal year. The improvement for the fiscal 2017 periods primarily reflects the increase in revenues year over year, as well as a decrease in operating expenses, primarily related to certain one-time costs incurred during the prior fiscal year that were not incurred this year.

COMPARATIVE CONSOLIDATED BALANCE SHEETS

Turning to the balance sheet, cash and cash equivalents totaled approximately \$3.0 million at September 30, 2017, compared with \$2.4 million at June 30, 2017. The increased cash balance is primarily the result of proceeds received with respect to our accounts receivable balance as well as the subscription receivable related to the June private placement.

On December 22nd, we completed a \$4.8 million registered direct offering. After deducting the placement agent's commission and other estimated offering expenses payable by us, the net proceeds are estimated to be approximately \$4.2 million, not including any amounts we may receive upon the exercise of the warrants. As of December 22nd, including the estimated net proceeds from above, our cash position is approximately \$4.9 million. This capital raise not only strengthened our balance sheet, but also gives us the financial flexibility with which to execute on our fiscal 2018 goals, which Jim will discuss in greater detail in a moment.

As of September 30, 2017 we had a total accounts receivable balance of approximately \$2.0 million due from cotton sales related to the former MOU, as well as new cotton orders. Due to the new contract payment terms and the settlement of the receivable balance from the former MOU, we expect to collect this outstanding balance in our fiscal first quarter.

As of September 30, 2017, our average monthly cash burn rate for fiscal 2017 was approximately \$332 thousand, compared to approximately \$869 thousand for the same period in the prior fiscal year, a decrease of approximately 62 percent. The significant reduction in monthly burn rate for fiscal 2017 compared to fiscal 2016 is mainly due to increased cash collections, primarily from cotton customers, as well as a decrease in cash expenditures.

We continue to closely monitor our spending, and intend to remain disciplined and continue to strategically manage costs in line with our current and near future market opportunities.

As of September 30, 2017, we estimate that our cash and cash equivalents along with the collection of our accounts receivables and the proceeds from the recent financing discussed are sufficient to fund operations for the next twelve months.

Thank you for joining us today and I would now like to turn it over to Jim for his comments.

Applied DNA Sciences – FQ4’17 Results Conference Call

James Hayward:

Thank you, Beth, and good afternoon everyone. Thank you for attending our conference call for the combined fourth fiscal quarter and year-end results.

Over the past fiscal year, we have worked diligently to capture the opportunities afforded us by our disruptive DNA platform and execute on a growth strategy that puts us on a path to greater revenues and profitability. While our technology is disruptive, we have spent this year to ensure that we provide a “constructive” path forward for 2018 to bolster existing business, cultivate new business and expand business overseas. We have focused on penetrating large commercial ecosystems, like our established textiles vertical, and, more recently, new verticals such as pharmaceuticals, personal care, fertilizers, and industrial materials such as bearings and their lubricants. Though disappointing, our fourth quarter financial performance **does not alter** what we have accomplished in fiscal 2017, nor does it reflect the momentum I believe we have accrued toward fiscal 2018.

SLIDE 6 Annualized Run Rate of Recurring Revenue, FY17

Let me share with you two data points that I believe best illustrate the progress we have made over the past year in executing against our growth strategy and that put us firmly on the path to our revenue and profitability goals.

Starting on **Slide 6**, we portray quarterly snapshots of the forward-looking Annualized Run Rate of Recurring Revenue throughout FY17. You will see that **exiting** fiscal 2016, we had established an annual recurring revenue run rate of approximately \$2mm per year. Exiting fiscal 2017, our efforts have driven a 3.5-fold increase in expected recurring revenues, to over \$6.5 million per year. The basis of this annual revenue run rate can be found principally in long-term contracts with guaranteed or minimum annual revenues with Himatsingka, Loftex and GHCL, as well as from our bulk DNA manufacturing business, from the tagging of automotive parts in Europe and including our DLA Part-Marking and Rapid Innovations Fund contracts. Textiles represent the majority of our recurring revenues today.

You will note that the trend takes a marked step up between Q2 and Q3 that coincides with the launch of our CertainT licensing strategy. Recall that with CertainT we not only generate revenue from the sale of our DNA as a taggant and the associated authentication services, but we also participate in the economics of the product when its value is at its highest; when it sits on a store shelf. This slide makes a compelling case for the continuing maturation of our business model and the further diversification of

our revenue streams. We believe that our drive to broaden adoption of our CertainT licensing strategy beyond our textile vertical to plastics, pharmaceuticals, fertilizers and recycled materials could have a valuable impact on revenue growth in fiscal 2018.

SLIDE 7 Feasibility Pilots by Quarter, FY2017

Turning to **Slide 7**, you can see the number of feasibility pilots has increased quarter by quarter throughout 2017, evidence of the growing market awareness of our platform. Our pipeline is growing because our DNA platform was proven in the cotton market and we have demonstrated the economic value of our solution in cotton to our partner, Himatsingka, and to several of its customers, chiefly Bed Bath and Beyond and Costco, and now additional retailers and brands.

Companies that represent diverse interests and locations within the supply chains of their industry, from Top End suppliers to new Retailers and Brand Owners, populate our pipeline of feasibility pilots.

Our current list has now grown to 24 pilots and includes programs in Personal Care, Print and Packaging, Pharmaceuticals, BioPharmaceuticals, Military, Industrial Products and Textiles, with non-cotton textiles representing about 30% of our current efforts. This diversity lowers our risk concentration, and increases our opportunities to gain large commercial ecosystems for our future product applications.

Together, these slides show that we are creating a stronger foundation on which to build our future growth.

Cotton

A review of fiscal 2017 must also include our performance in the fiscal fourth quarter and especially when viewed in the context of the 2017-2018 cotton ginning season. As our most developed market, textiles are our largest contributor to revenue, and currently include cotton, synthetics and leather. As we are in the middle of the 2017/2018 cotton-ginning season that spans both our fiscal fourth and first quarters, I want to touch on the demand for our DNA platform from this market following the signing of our new exclusive licensing agreement with Himatsingka in June of this year.

SLIDE 8 Cotton Sales and Demand Trends

In the United States, cotton is planted, grown and harvested only once a year. The ginning season immediately follows harvest, and this period is our singular opportunity to tag the cotton with our SigNature® T Molecular tag. The tagged cotton is baled and then warehoused, and shipped upon demand to the spinners and the rest of the supply chain when the retailers need new product.

As you can see on **Slide 8**, which portrays Cotton Sales and Demand Trends, the demand for tagged cotton – denoted by the bars – has grown steadily year-over-year. Our revenue from cotton – denoted by the line graph – has not matched this growth principally because our prior business model was based on DNA purchases with no historical run-rate and an outlook of demand from our partners. In fiscal 2015, this resulted in orders to us of nearly 4 million dollars, but it also created an **over-supply situation** that persisted into fiscal 2016. **During FY2016, demand for marked cotton was met with DNA sold in fiscal 2015.** As a consequence, cotton revenue dipped steeply downward in 2016 (as evident in the negative slope of the red line over the second column from the left), our cotton revenue that fiscal year was below the market’s consumption of tagged cotton.

Payment terms through our prior business model were also a burden on our Company, with cash receipts typically taking 18 months to collect. This was not a viable long-term strategy for us, so in fiscal 2017 we decided to leverage the market’s growing demand for tagged cotton to secure more favorable economics in a cotton business model among partners better constructed for Applied DNA’s interests.

With the signing of the agreement with Himatsingka, we secured much more favorable payment terms – net 60 days – and gained more predictable cash flows as well as a greater gross margin than under our prior arrangement. Selling directly to our end-customer and no longer through an intermediary reduces complexity, improves communications and the balancing of supply and demand with shorter lead times. Orders for our taggant are now Just-In-Time, as evident in the Tagged Cotton Sold being now more fully in synchrony with the quantity of Cotton Tagged in our estimates of 2017 and 2018. Because of this, **going forward we expect to receive orders from Himatsingka throughout the fiscal year** in contrast to prior years in which we typically received orders only at the start of the ginning season. Nonetheless, we should still expect seasonality to affect the timing of cotton revenue.

With growing adoption of our DNA taggant by the cotton market, and longer-term contracts with retailers secured through Himatsingka, we can now begin to predict demand in the coming year. As you can see on the right hand-most column, we predict that demand in fiscal 2018 will continue to increase, and long after ginning and tagging has ended for the current season.

Recall that I noted moments ago that the only opportunity to tag cotton is when it is ginned. If retailer demand were to increase after the ginning season was over, it would result in a delayed or missed revenue opportunity for our partners and us. We have therefore made the strategic decision to supply additional taggant beyond committed orders to our collaborating gins to cover cotton opportunities

being worked by us, our merchant and Himatsingka. Upon receipt of an order for tagged cotton, Himatsingka will buy the DNA taggant from us sufficient to cover the order.

Since the cotton program began 3 years ago, we have literally transformed the industry's reliance on a paper trail to a forensic proof of origin. Fast forward, we have demonstrated that in a relatively short period of time from 5 million lbs in 2014 to an accumulated total of over 200 million lbs of cotton by 2017, our DNA technology has the capacity to scale to tag billions of pounds of fibers; it is accepted in the marketplace, and we believe it has the potential to extend beyond home textiles to apparel, in the US and internationally. Providing proof of origin is no longer considered a **"nice to have"** but a **"must have"**. And demand is increasing internationally, as seen by inquiries we are fielding about cottons from Australia and Turkey.

We are participating in the Industrial Internet of Things with our DNA Transfer Systems in 7 gins; we are managing our cotton contract fulfillments with our partners Himatsingka and Louis Dreyfus; we have tested over 3000 samples of cotton through the supply chain.... all within our Textiles cloud-based platform. This season we are collecting over 685,000 sensor and controls data points **daily** into our cloud with real-time monitoring of spray quality, linkage to USDA bale ID's and tracking of cotton pounds marked aligned to DNA usage. This platform gives confidence to manufacturers and retailers of the quality of the cotton flowing through our system. It is also configurable for supply chains in synthetics and other CertainT prospects we have in the pipeline.

As long as our market penetration continues to grow – and right now and for the conceivable future **we are the market** for DNA tagged cotton – we can expect to tag more than we can recognize as revenue in each fiscal year to meet the forecasted market demand in the following fiscal year, but before new supply can be available from the new harvest.

As you can also see on **Slide 8**, we are **for the first time** forecasting revenue for DNA sales from cotton tagging of over \$4.4 million for fiscal 2018, an increase of more than 80% over fiscal 2017. The potential for upside beyond this is significant with new interests from brands and retailers. To meet that potential demand, Applied DNA has created a contingent reserve of more than \$1.4 million worth of DNA on tagged cotton at our cooperating gins that can help to meet any FY2018 pre-harvest requirements. Any incremental demand beyond this level can be met by additional shipments within the 2018 harvest, both before and after the end of our current fiscal year.

Slide 9 Blockchain DNA

No other system has proven in the market (not even block chain or RFID) that you can physically trace every fiber tagged from farm to shelf while maintaining the economic scalability, and sustainability, of this secure supply chain system. And as for blockchains, let me point out that as valuable as blockchains are likely to be in logistics, all blockchain methods suffer from a common limitation – the most trusted blockchain ledger in the world will not be able to tell if criminals have substituted bad or counterfeit goods for the originals. Without a DNA tag that provides forensic tracking back to the origin, how does any blockchain prove that an initial distributed entry in any ledger represents authentic goods? We believe that SigNature DNA should be the backbone to any blockchain that requires a forensically certified node. We believe that this translates well for our business in general, and for many of our developing opportunities.

Fiscal 2018

As we look ahead to fiscal 2018, our goal is to continue to drive toward greater revenues and eventual profitability. For those of you who listened to our fiscal third quarter conference call in August, you will recall that I stated that if we were to hold our expenses to where they were in the third quarter and maintain that quarter's gross margin mix, we would become cash flow positive at revenues of approximately \$3.5 million per quarter or \$14 million per year.

Having established a foundation of growing recurring revenues entering fiscal 2018, we are today approximately **halfway** to our cash break-even point. Let me touch on several recent developments I believe will contribute to revenue growth in the current year and continue our progress towards break-even.

In addition to our expectation for very strong growth in cotton revenues in fiscal 2018 (and it is worth pointing out that of the \$4.4 million we are projecting for FY18, nearly \$4 million is already baked into our expected Recurring Revenue base) I noted earlier that we exited fiscal 2017 with 23 feasibility projects in our pipeline. That number is presently 24. Each is an opportunity for a commercial-scale deployment of our platform and associated services. Two of these pilots have already commercialized, and it is likely that most of the textile projects will transition quickly.

We also see opportunity for revenue growth in the verticals in which we already have an established foothold, my remaining comments will address these opportunities.

Synthetics

Within textiles, we have already seen synthetic fiber customers expand their initial CertainT licenses and we anticipate that additional synthetic fiber manufacturers brought on over the course of the fiscal year will engage in similar licenses. They have expanded to cover more types of synthetics particularly those following the cotton value proposition into home products and apparel.

CertainT, however, is applicable not only to synthetics. We anticipate its adoption across fertilizer, pharma and most of our supply chain markets. Over time we hope for it to become the global standard brand for traceability, transparency and trust

We have expanded the CertainT program for PET recyclers in both India and in China, to service extended term licensing agreements with GHCL and with Loftex, respectively. Both agreements call for guaranteed minimum annual revenues and licensing royalties.

Leather

Staying with textiles, work on the leather feasibility studies with our project sponsors continues to exceed everyone's expectations and the project is on target for completion at the end of March 2018. We have already started discussions to commercialize the tagging of leather and expect to turn this into a good revenue stream during fiscal 2018.

Distributors/Automotive Asset Tagging

Safesolutions SmartDNA AB continues to be very active in Scandinavia and has recently secured an extension of a contract with a prestigious German car manufacturer and they have recently added staff to their salesforce to help increase sales in the area. We are also due to recruit new distributors for the territories of Ecuador, Japan and Ireland in the New Year.

SLIDE 10 Fertilizer

Following the conclusion of a pilot project for the large-scale molecular tagging of fertilizer that was successfully tracked through a West African supply chain earlier this year, our partner and market leader Rosier, a division of Borealis, is pulling us through the global fertilizer supply chain as a commercialized product. Together, we are now preparing to enter geographies that account for 60% of global fertilizer consumption. Interest is being driven by agro-economies to prevent and secure supply chains from fertilizer adulteration, and we anticipate that tagged fertilizer may enter targeted markets during early calendar 2018 and additional locations thereafter throughout calendar 2018.

We also anticipate demand for tagged fertilizer in Turkey with the implementation of a federal mandate effective January 1 that requires the DNA-tagging of all domestically produced fertilizer and secure packaging, including the use of secured bar codes. This mandate comes in response to a series of acts of terror that utilized fertilizer-based explosives in Turkey in 2016. Having engaged the government in Turkey since mid-2016, we believe that our DNA platform was the catalyst for the government's mandate and will create demand for our taggant in the country. We are engaged with domestic Turkish fertilizer manufacturers to meet this mandate.

SLIDE 11 Videojet

We announced a strategic partnership with Videojet Technologies in late September.

By identifying and partnering with market leaders like Videojet and their sophisticated sales teams, we accelerate our time-to-revenue in our key business verticals. Market leaders already own the customer relationships we seek and they understand fully the workings of the supply chains in which they are engaged. We supply a truly scalable and seamless technology that gives their offering a competitive advantage in the marketplace, thereby enabling them to defend their market share and gain new market share. We gain new sales by leveraging their salesforce to access their installed customer base, participating in sales of the printer and follow-on sales of DNA-tagged ink cartridges.

Videojet, one of the largest in the world for inkjet printing and marking systems, with 650 salespeople globally, has 325,000 installed machines that mark more than 10 billion items daily with barcodes and other variable information across disparate supply chains, including Military and Government, Personal Care and in pharmaceutical serialization. With Videojet, we have vastly expanded the potential universe of items that can be tagged with DNA ink and can offer a solution that can be easily integrated into a manufacturer's production lines to seamlessly tag their widgets. When inkjet printing is used to print packaging, the marketplace is almost limitless.

As part of our partnership, we launched a co-branded printer with shared revenues to Applied DNA that is designed to use only **DNA-infused inks**. With the co-branded printer, Videojet can offer its customer base a replacement technology that still prints barcodes and other information, but now turns each printer and ink cartridge into a secure supply chain certification tool. Once the printer is installed, the customer represents a long-term opportunity for the repeated sale of cartridges of DNA-infused ink and our CertainT platform.

The Videojet security printer is ideally suited for high volume printing on a production line and is specifically targeted to manufacturers to tag parts. Our targets are brand protection and others tasked with the security of the brand and supply chain within DoD agencies and at the OEMs that sell to the military.

As a first step, we have begun to train Videojet's salespeople to make them effective proponents of our technology platform. We also see substantial cross-selling opportunities within our respective current and potential customer bases. I would note that this partnership is proceeding quickly, and that while the initial announcement was centered on a black, pigmented ink, we are already developing additional types of inks appropriate for different applications that will have the advantage of an accelerated go-to-market timeline. We recently presented together to the marketplace at the DMC exhibit in Florida, where our platform was received with great interest.

SLIDE 12 Colorcon

Pharma/BioPharma

Patient Safety is increasingly under jeopardy due to drug counterfeiting and drug diversion, facilitated, in part, by the fragmented, complex, international nature of the pharmaceutical supply chain. The passing of the Drug Supply Chain Security Act was a watershed moment in enhancing patient safety through the serialization of pharmaceutical packaging. However we feel that there is a significant and immediate opportunity to further strengthen the security of global pharmaceutical supply chains, via augmentation of serialization with SigNature® DNA.

A growing body of experience suggests that patient demand for pharmaceutical authentication is going to grow in the years ahead, as a result of factors directly related to the loss of supply chain controls.

On December 14th, we announced a memorandum of understanding with Colorcon, who brings their excipients and coatings, which are wonderful carriers for SigNature DNA, directly into most of the large pharmaceutical companies in the world and to many nutraceutical manufacturers. The MOU is non-binding, but we expect to sign a definitive agreement very soon.

Upon signing the definitive agreement, we expect to begin receiving milestone payments, and with sales to their customers, begin revenue sharing for product sales and for services.

We expect to complete our Drug Master File, or "DMF" over the next month and then review it together with Colorcon, with a subsequent filing with FDA shortly thereafter. This is slightly later than I had

advised some months back, but reflects our effort to take the best plausible path with our FDA compliance. With industry-leading subject matter experts in regulatory and compliance, Colorcon has guided us toward a DMF on file with the FDA, which will accelerate the time to implementation for our joint customers as we commercialize. Just having gone through the process gives a sense of confidence to the sales teams and customers. The purpose of the DMF is to facilitate compliance with FDA standards for our first customers who take DNA tagging on their branded solid oral doses to market. Once filed, we will have the regulatory confidence to engage with potential pharmaceutical customers who wish to deploy our molecular tag in their products. To be clear, there is no expectation of an FDA response to the filing of a DMF.

Molecular tagging – turning the tablet into its own barcode – complements the FDA regulation for package serialization, which is our approach with Videojet. Together, Applied DNA, Colorcon and Videojet can offer the pharmaceutical industry for the first time, end-to-end supply security that is well beyond current global mandates. And most importantly, we can do so with channel sales support by teams hundreds of times larger than our own.

On a related but distinct topic, we continue to cultivate strong interests in our ability to manufacture functional DNA, quite more complex than our intentionally non-functional DNA tags, from the biopharmaceutical industry. Our contracts for DNA production for diagnostics are stable and productive, and part of our growing base of recurring revenue. In addition, we continue to quote on pilot studies for functional DNA in gene therapies and for vaccine. We were able to convert 2 of 3 Vandalia customers to our own long-term customers. The third customer withdrew their product from the marketplace. In retrospect, our acquisition of Vandalia has proven to be extremely valuable to our capabilities, and to our current and future revenues.

Conclusion

Slide 13 FY18 Roadmap For Growth

In conclusion, we expect fiscal 2018 to evidence a significant ramp in revenues. Our expected Annualized Recurring Revenue Run at the start of FY18 is approximately \$6.5 million per year. We can expect to add to this base, in part through our recent agreements with Videojet and Colorcon, as we work in alliance to acquire customers. Beyond the growing recurring base, we can also expect to add incremental revenue within the quarters, as key pilots convert to commerce.

Let me enumerate our short-term goals, as shown on my final slide:

Firstly, increase our revenues from industry verticals in which we are already established, especially textiles. We are seeking independent growth from cotton and from synthetic fibers, including recycled PET. We have secured incremental business with existing customers and partners, the interests of new retailers, as well as new brands and new geographic markets, and we are taking action to realize these sales.

Secondly, leverage the Sales Channels that are already established with new partners whose selling teams are much larger than ours, such as Colorcon and Videojet, and textile players Techmer, Loftex and GHCL. We are already actively training their sales teams, identifying our initial sales targets and sales goals for the year.

Thirdly, increase the number of CertainT™ licensees, which adds revenue that goes straight to our bottom line.

And finally, tailor the applicability of our technology platform to enter markets adjacent to our core markets such as personal care.

This concludes my prepared remarks. I'd like to thank you for your continued support of Applied DNA, and on behalf of the company, I'd like to wish you all the best of this holiday season.

Operator, please open the line to questions. Thank you.