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BIOMERICA INC  
Form 10QSB  
October 15, 2004

FORM 10-QSB  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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

For Quarter Ended August 31, 2004  
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Commission File No. 0-8765  
-----

BIOMERICA, INC.

-----  
(Exact name of registrant as specified in its charter)

Delaware

95-2645573

-----  
(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

1533 Monrovia Avenue, Newport Beach, California

92663

-----  
(Address of principal executive offices)

(Zip Code)

Registrant's telephone number including area code: (949) 645-2111  
-----

(Not applicable)

-----  
(Former

name, former address and former fiscal year, if  
changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the Registrant is an accelerated filer (as Defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 5,752,431 shares of common stock as of October 15, 2004.

BIOMERICA, INC.

INDEX

PART I

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Item 1. Consolidated Financial Statements:

Consolidated Statements of Operations and Comprehensive Loss (unaudited) - Three Months Ended August 31, 2004 and 2003.....1 & 2

Consolidated Balance Sheet (unaudited) - August 31, 2004.....3 & 4

Consolidated Statements of Cash Flows (unaudited) - Three Months Ended August 31, 2004 and 2003.....5

Consolidated Statement of Changes in Shareholders' Equity (unaudited) - Three Months Ended August 31, 2004.....6

Notes to Consolidated Financial Statements (unaudited) .....7-15

Item 2. Management's Discussion and Analysis of Financial Condition and Selected Financial Data.....16-17

Item 3. Quantitative and Qualitative Disclosures about Market Risk.....18-19

Item 4. Controls and procedures.....19

PART II Other Information.....20

Item 1. Legal Proceedings.....20

Item 2. Changes in Securities and Use of Proceeds.....20

Item 3. Defaults upon Senior Securities.....20

Item 4. Submission of Matters to a Vote of Security Holders.....20

Item 5. Other Information.....20

Item 6. Exhibits and Reports on Form 8-K.....20

Signatures.....21

PART I - FINANCIAL INFORMATION  
SUMMARIZED FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS

BIOMERICA, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
AND COMPREHENSIVE LOSS (UNAUDITED)

	Three Months Ended August 31,	
	2004	2003
	-----	-----
Net sales .....	\$ 2,184,437	\$ 2,164,360

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Cost of sales .....	(1,506,496)	(1,503,564)
Gross profit .....	677,941	660,796
Operating Expenses:		
Selling, general and administrative .....	710,063	897,549
Research and development .....	71,049	74,340
	781,112	971,889
Operating loss from continuing operations .....	(103,171)	(311,093)
Other Expense (income):		
Interest expense .....	8,118	10,462
Other income, net .....	(13,435)	( 7,011)
	(5,317)	3,451
Loss from continuing operations, before minority interest in net loss of consolidated subsidiaries and income taxes	( 97,854)	(314,544)
Minority interest in net losses of consolidated subsidiaries .	47,709	96,580
Loss from continuing operations, before income taxes .....	(50,145)	(217,964)
Income tax expense .....	0	0
Net loss from continuing operations .....	(50,145)	(217,964)

1

BIOMERICA, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
AND COMPREHENSIVE LOSS - Continued (UNAUDITED)

Discontinued operations:		
Income (loss) from discontinued operations, net .....	--	76
Net loss .....	(50,145)	(217,888)
Other comprehensive gain (loss), net of tax		
Unrealized gain (loss) on available-for-sale securities .....	(5,590)	41,503
Comprehensive loss .....	\$ (55,735)	\$ (176,385)
Basic net loss per common share:		
Net loss from continuing operations .....	\$ (.01)	\$ (.04)
Net loss from discontinued operations .....	.00	.00
Basic net loss per common share .....	\$ (.01)	\$ (.04)

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	=====	=====
Diluted net loss per common share:		
Net loss from continuing operations .....	\$           (.01)	\$           (.04)
Net loss from discontinued operations .....	.00	.00
	-----	-----
Diluted net loss per common share .....	\$           (.01)	\$           (.04)
	=====	=====
Weighted average number of common and common equivalent shares:		
Basic and diluted .....	5,752,431	5,716,607
	=====	=====

The accompanying notes are an integral part of these statements.

2

BIOMERICA, INC.

CONSOLIDATED BALANCE SHEET (UNAUDITED)

	August 31, 2004
	-----
Assets	
Current Assets	
Cash and cash equivalents .....	\$ 141,115
Available for-sale securities .....	20,530
Accounts receivable, less allowance for doubtful accounts of \$167,411	1,597,104
Inventories, net .....	2,868,162
Notes receivable .....	3,519
Prepaid expenses and other .....	171,675
	-----
Total Current Assets .....	4,802,105
Inventory, non-current .....	20,000
Property and Equipment, net of accumulated depreciation and amortization	741,818
Intangible assets, net of accumulated amortization .....	22,858
Other Assets .....	62,240
	-----
	\$5,649,021
	=====

The accompanying notes are an integral part of these statements.

3

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BIOMERICA, INC.

CONSOLIDATED BALANCE SHEET - Continued (UNAUDITED)

August 31,  
2004

Liabilities and Shareholders' Equity

Current Liabilities

Line of credit .....	\$	--
Accounts payable and accrued liabilities .....		1,063,285
Accrued compensation .....		537,092
Current portion of shareholder loan .....		317,318
Net liabilities from discontinued operations .....		288,296

Total Current Liabilities ..... 2,205,991

Minority interest ..... 2,566,192

Shareholders' Equity

Common stock, \$0.08 par value authorized 25,000,000 shares, subscribed or issued and outstanding 5,752,431 .....		460,193
Additional paid-in-capital .....		17,131,305
Accumulated other comprehensive gain .....		12,876
Accumulated deficit .....		(16,727,536)

Total Shareholders' Equity ..... 876,838

Total Liabilities and Equity ..... \$ 5,649,021

The accompanying notes are an integral part of these statements.

4

BIOMERICA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

For the three months ended August 31,

2004

2003

Cash flows from operating activities:

Net loss from continuing operations ..... \$ (50,145) \$ (217,964)

Adjustments to reconcile net loss to net cash

(used in) provided by operating activities:

Depreciation and amortization ..... 45,597 27,261

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Amortization of warrant expense for extension of loan .....	10,400	--
Minority interest in net loss of consolidated		
Subsidiary .....	(47,709)	(96,580)
Gain on sales of marketable securities .....	(2,068)	--
Common stock, warrants and options issued for services		
rendered .....	--	48,080
Provision for losses on accounts receivable .....	(4,991)	(5,142)
Changes in current assets and liabilities:		
Accounts Receivable .....	(74,830)	173,295
Inventories .....	(195,319)	(69,348)
Prepaid expenses and other current assets .....	(6,852)	23,582
Accounts payable and other accrued liabilities .....	80,506	(103,308)
Accrued compensation .....	71,169	92,453
	-----	-----
Net cash used in operating activities .....	(174,242)	(127,671)
	-----	-----
Cash flows from investing activities:		
Sales of available-for-sale securities .....	2,068	--
Purchases of property and equipment .....	(61,585)	(165,330)
Other assets .....	--	(13,419)
	-----	-----
Net cash used in investing activities .....	(59,517)	(178,749)
	-----	-----
Cash flows from financing activities:		
Change in minority interest .....	22,500	2,430
Increase (decrease) in shareholder loan .....	--	34,285
Private placement, net of offering costs .....	--	30,500
Exercise of stock options .....	--	2,000
Decrease in line of credit .....	--	(5)
	-----	-----
Net cash provided by financing activities .....	22,500	69,210
	-----	-----
Net cash used in discontinued operations .....	--	(209)
	-----	-----
Net decrease in cash and cash equivalents .....	(211,259)	(237,419)
Cash and cash equivalents at beginning of period .....	352,374	525,167
	-----	-----
Cash and cash equivalents at end of period .....	\$ 141,115	\$ 287,748
	=====	=====
Supplemental disclosures on non-cash financing activity		
Issuance of common stock at market value in exchange for		
settlement of accrued wages and shareholder loan .....	\$ --	\$ 20,000
Change in minority interest due to subsidiary stock issuance ....	\$ (4,100)	\$ --
	=====	=====

The accompanying notes are an integral part of these statements.

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BIOMERICA, INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)  
FOR THE THREE MONTHS ENDED AUGUST 31, 2004

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Gain (loss)	Accumulated Deficit
	Number of Shares	Amount			
Balance at May 31, 2004	5,752,431	\$ 460,193	\$ 17,125,005	18,466	\$(16,677,391)
Change in unrealized gain on available for sale securities				(5,590)	
Expense related to issuance of warrants for extension of note			10,400		
Issuance of stock at subsidiary			(4,100)		
Net loss					(50,145)
	5,752,431	\$ 460,193	\$ 17,131,305	\$ 12,876	\$(16,727,536)

6

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

August 31, 2004

(1) Reference is made to Note 2 of the Notes to Consolidated Financial Statements contained in Biomerica, Inc.'s (the "Company") Annual Report on Form 10-KSB for the fiscal year ended May 31, 2004, for a summary of significant accounting policies utilized by the Company.

(2) As of August 31, 2004, the Company had cash and available-for-sale securities in the amount of \$161,645 and working capital of \$2,596,114. Cash and working capital totaling \$126,905 and \$2,746,045, respectively, relates to the Lancer subsidiary. Lancer's line of credit restricts Biomerica's ability to draw on Lancer's resources and, as such, said cash, working capital and equity are not available to Biomerica.

The Company has suffered substantial recurring losses from operations over the last several years. Biomerica has funded its operations through debt and equity financings, and may have to do so in the future. ReadyScript operations

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were discontinued in May 2001 and Allergy Immuno Technologies, Inc. was sold in May 2002. ReadyScript and Allergy Immuno Technologies were previously contributors to the Company's losses. In fiscal years 2004 and 2003, the Company reduced operating costs through certain cost reduction efforts and plans to concentrate on its core business in Lancer and Biomerica to increase sales. There can be no assurance that the Company will be able to become profitable, generate positive cash flow from operations or obtain the necessary equity or debt financing to fund operations in the future. Should the Company be unable to reduce costs or increase sales adequately or should the Company be unable to secure additional financing, the result for the Company could be the inability to continue as a going concern.

The Company will continue to have limited cash resources. Biomerica, as a parent entity, has no open or existing, operating line of credit or loans on which it can draw any debt financing and we are not currently in negotiations to obtain such financing. Although the Company's management recognizes the imminent need to secure additional financing or increase sales, there can be no assurance that the Company will be successful in doing so or, if the Company does consummate a financing, that the terms and conditions of such financing will not be unfavorable to the Company.

Our independent certified public accountants have concluded that these factors, among others, raise substantial doubt as to the Company's ability to continue as a going concern for a reasonable period of time, and have, therefore modified their audit report on the Company's annual consolidated financial statements as of and for the year ended May 31, 2004, in the form of an explanatory paragraph describing the events that have given rise to this uncertainty. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

These consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company has operating and liquidity concerns due to historically reporting net losses and negative cash flows from operations.

Biomerica entered into an agreement for a line of credit agreement on September 12, 2000 with a shareholder whereby the shareholder would loan to the company, as needed, up to \$500,000 for working capital needs. The line of credit bore interest at 8%, was secured by accounts receivable and inventory, and expired September 13, 2003. In March 2004 the Company signed a note payable for the principal and interest due at that time of \$313,318 and agreed to a forbearance of any payments for the length of the agreement. A warrant for 40,000 shares of restricted common stock exercisable at a price of \$.51 per share was awarded as compensation for the forbearance. The note payable is secured by all of the Company's assets except for the Lancer common stock owned by Biomerica. The note was due September 1, 2004. There was \$313,318 of outstanding principal and \$11,754 interest payable under this note payable at August 31, 2004. An agreement is being finalized which provides for monthly payments and an extension of the note for one year.

During the quarters ended August 31, 2004 and 2003, the Company's operations used cash of \$174,242 and \$127,671, respectively. Cash provided by financing activities was \$22,500, which resulted from changes in minority interest in Lancer.



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Compensation - Transition and Disclosure-an amendment to SFAS No. 123". SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. The Company currently does not intend to adopt SFAS No. 123 and the implementation of SFAS No. 148 did not have a material effect on the Company's consolidated financial position or results of operations.

The Black Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuations models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options. For purposes of pro forma disclosure, the estimated fair value of the options is amortized to expense over the options vesting period. Adjustments are made for options forfeited prior to vesting. The effect on compensation expense, net loss, and net loss per common share had compensation costs for the Company's stock option plans been determined based on a fair value at the date of grant consistent with the provisions of SFAS 148, for the quarter ended August 31 is as follows:

AUGUST 31,	2004	2003
-----		
Net loss from continuing operations, as reported	\$ (50,145)	\$ (217,964)
Plus: Stock-based employee compensation expense included in reported net loss	--	48,080
Less: Stock-based employee compensation expense determined using fair value based method	(3,892)	(73,304)
-----		
Net loss from continuing operations, pro forma	\$ (54,037)	\$ (243,188)
=====		
Pro forma net loss from continuing operations per share - basic	\$ (0.01)	\$ (0.04)
=====		
Pro forma net loss from continuing operations per share - diluted	\$ (0.01)	\$ (0.04)
=====		
Net income (loss) from discontinued operations, as reported	\$ --	76
Plus: Stock-based employee compensation expense included in reported net loss	--	--
Less: Stock-based employee compensation expense determined using fair value based method	--	--
-----		
Net loss from discontinued operations, pro forma	\$ --	\$ 76
=====		
Pro forma net loss from discontinued operations per share - basic	\$ .00	\$ (0.00)

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Pro forma net loss from discontinued operations per share - diluted	\$ .00	\$ (0.00)
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(4) The following summary presents the options granted, exercised, expired, and outstanding as of August 31, 2004:

	Number of Options and Warrants			Weighted Average Exercise Price
	Employee	Non-employee	Total	
Outstanding May 31, 2004	2,428,808	1,228,829	3,657,637	\$ 2.17
Granted	--	--	--	--
Exercised	--	--	--	--
Expired	--	--	--	--
Outstanding August 31, 2004	2,428,808	1,228,829	3,657,637	\$ 2.17

8

(5) The information set forth in these condensed consolidated statements is unaudited and may be subject to normal year-end adjustments. The information reflects all adjustments which, in the opinion of management, are necessary to present a fair statement of the consolidated results of operations of Biomerica, Inc., for the periods indicated. It does not include all information and footnotes necessary for a fair presentation of financial position, results of operations, and cash flow in conformity with generally accepted accounting principles.

(6) Consolidated results of operations for the interim periods covered by this Report may not necessarily be indicative of results of operations for the full fiscal year.

(7) Reference is made to Note 3 of the Notes to Consolidated Financial Statements contained in the Company's Annual Report on Form 10-KSB for the fiscal year ended May 31, 2004, for a description of the investments in affiliates and consolidated subsidiaries.

(8) Reference is made to Notes 5 & 10 of the Notes to Consolidated Financial Statements contained in the Company's Annual Report on Form 10-KSB for the fiscal year ended May 31, 2004, for information on commitments and contingencies.

(9) Aggregate market value exceeded cost of available-for-sale securities by approximately \$12,876 at August 31, 2004.

(10) Earnings Per Share

In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards (SFAS) No. 128, EARNINGS PER SHARE ("EPS"). SFAS No. 128 requires dual presentation of basic EPS and diluted EPS on the face of all income statements issued after December 15, 1997 for all



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impairment or disposal of long-lived assets." SFAS No. 144 requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. Therefore, discontinued operations will no longer be measured at net realizable value or include amounts for operating losses that have not yet occurred. SFAS No. 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001 and, generally, is to be applied prospectively. This standard was effective for the Company's consolidated financial statements beginning June 1, 2002. The implementation of SFAS No. 144 did not have a material impact on the Company's consolidated financial position or results of operations.

In April 2002, the FASB issued SFAS No. 145, "Rescission of SFAS No. 44 and 64, Amendment of SFAS No. 13, and Technical Corrections," to update, clarify and simplify existing accounting pronouncements. SFAS No. 4, which required all gains and losses from debt extinguishment to be aggregated and, if material, classified as an extraordinary item, net of related tax effect, was rescinded. Consequently, SFAS No. 64, which amended SFAS No. 4, was rescinded because it was no longer necessary. The adoption of this statement did not have a material effect on the Company's consolidated financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)." SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value when the liability is incurred. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The adoption of this statement did not have a material effect on the Company's consolidated financial position or results of operations.

In November 2002, FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," was issued. FIN 45 requires that upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. FIN 45 also requires additional disclosures by a guarantor in its interim and annual financial statements about the obligations associated with guarantees issued. The recognition provisions of FIN 45 are effective for guarantees issued after December 31, 2002, while the disclosure requirements were effective for financial statements for periods ending after December 15, 2002. The adoption of FIN 45 did not have a material impact on the Company's consolidated financial position or results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities". In December 2003, FIN 46 was replaced by FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities." FIN 46R clarifies some of the provisions of FIN 46 and exempts certain entities from its requirements. FIN 46R was effective at the end of the first interim period ending March 15, 2004. Entities that have adopted FIN 46 prior to this date can continue to apply provisions of FIN 46 until the effective date of FIN 46R or early election of FIN 46R. This interpretation clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," relating to consolidation of certain entities. FIN No. 46 requires identification of the Company's participation in variable interests entities ("VIEs"), which are defined as entities with a level of invested equity that is not sufficient to fund future activities to permit them to operate on a stand-alone basis, or whose equity holders lack certain characteristics of a controlling financial interest. For entities identified as VIEs, FIN No. 46 sets

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forth a model to evaluate potential consolidation based on an assessment of which party to the VIE, if any, bears a majority of the exposure to its expected losses, or stands to gain from a majority of its expected returns. FIN No. 46 also sets forth certain disclosures regarding interests in VIE that are deemed significant, even if consolidation is not required. The adoption of FIN No. 46 did not have a material impact on the Company's financial position or results of operations.

10

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement is effective for contracts entered into or modified after June 30, 2003. The adoption of this statement did not have a significant effect on the Company's consolidated financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150 ("SFAS No. 150"), "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 provides guidance on how an entity classifies and measures certain financial instruments with characteristics of both liabilities and equity. Many of these instruments were previously classified as equity. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The statement requires cumulative effect transition for financial instruments existing at the adoption date. The adoption of this statement did not have a material effect on the Company's consolidated financial position or results of operations.

(12) Financial information about foreign and domestic operations and export sales is as follows:

	For the Three Months Ended	
	8/31/04	8/31/03
	-----	-----
Revenues from sales to unaffiliated customers:		
United States	\$1,029,000	\$1,128,000
Asia	71,000	45,000
Europe	616,000	529,000
South America	89,000	146,000
Middle East	78,000	60,000
Oceania	160,000	132,000
Other	141,000	124,000
	-----	-----
	\$2,184,000	\$2,164,000
	=====	=====

No other geographic concentrations exist where net sales exceed 10% of total net sales.

(13) Pursuant to a decision by the Nasdaq Listing Qualifications Panel, the Company's common stock was delisted from the Nasdaq Stock Market effective June 20, 2002, for failure to comply with the net tangible assets or shareholders' equity requirements as set forth in Marketplace Rule 4310(c)(2)(B). The

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Company's securities were immediately eligible to trade on The OTC Bulletin Board and are traded under the symbol BMRA.OB.

(14) Lancer has a \$400,000 line of credit with Cuyamaca Bank, expiring January 8, 2005. Borrowings are made at prime plus 2.0% (6.5% at August 31, 2004), and are limited to 80% of accounts receivable less than 90 days old. The outstanding balance at August 31, 2004 was \$0 and the unused portion available was approximately \$340,000. Lancer requested that Cuyamaca Bank reserve \$60,000 of its available credit line as a guarantee of credit with a European supplier. Lancer is in compliance with its debt covenants at August 31, 2004.

The line of credit is collateralized by substantially all the assets of Lancer, including inventories, receivables, and equipment. The lending agreement for the line of credit requires, among other things, that Lancer maintain a balance sheet net worth of \$2,700,000 and that a zero outstanding balance be maintained for 30 consecutive days during the term. Proceeds from this line cannot be used to support the operations of Biomerica.

Lancer also had a term loan for \$100,000 with Cuyamaca Bank that was paid off in May 2004. This loan required monthly payments of approximately \$2,300 (principal and interest) at an interest rate of prime plus 2% (6% at May 31, 2004).

11

Biomerica entered into an agreement for a line of credit agreement on September 12, 2000 with a shareholder whereby the shareholder would loan to the Company, as needed, up to \$500,000 for working capital needs. The line of credit bore interest at 8%, was secured by accounts receivable and inventory, and expired September 13, 2003. In March 2004 the Company signed a note payable for the principal and interest due at that time of \$313,318 and agreed to a forbearance of any payments for the length of the agreement. A warrant for 40,000 shares of restricted common stock exercisable at an exercisable price of \$.51 per share was awarded as compensation for the forbearance. The note payable is secured by all the Company's assets except for the Lancer common stock owned by Biomerica. The note payable expired September 1, 2004. The Company is in the process of finalizing an agreement which calls for monthly payments and extends the due date of the note for one year.

(15) During 2003, the Company agreed to sell 18,000 shares of its common stock at a selling price of \$0.25 per share. Proceeds to the Company were \$4,500. As of May 31, 2003, the shares had not been issued and were accordingly classified as common stock subscribed. These shares were issued during 2004, and have accordingly been transferred to common stock issued and outstanding.

During 2003, the Company sold 142,000 shares of its common stock at a selling price of \$0.25 per share. Proceeds to the Company were \$35,500.

During 2003, the Company issued 177,627 shares of common stock to employees as compensation. The Company valued these shares at \$69,267.

During 2002, the Company issued 20,000 shares of common stock to a consultant for legal services provided. As of May 31, 2002, these shares were classified as common stock subscribed and valued by the Company at \$20,000. These shares were issued as of May 31, 2003. During 2003, the Company issued this consultant an additional 2,107 shares of common stock for legal services provided. The Company valued these shares at \$611.

During 2004, the Company sold 202,000 shares of common stock at a selling

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price of \$0.25 per share. Proceeds to the Company were \$50,500. Warrants to purchase 202,000 shares of the Company's restricted common stock at an exercise price of \$0.25 were also granted as part of the private placement.

During 2004 the Company issued 10,000 shares of its common stock as the result of an exercise of options granted in prior years. Proceeds to the Company were \$2,000.

### Subsidiary Sale of Stock

During the year ended May 31, 2004 the Company recognized a reduction in its additional paid capital in the amount of \$112,719 resulting from a decrease in its ownership percentage of Lancer as a result of Lancer's sale of common stock.

During the quarter ended August 31, 2004 the Company recognized a reduction in its additional paid capital in the amount of \$4,100 resulting from a decrease in its ownership percentage of Lancer as a result of Lancer issuing shares of common stock during the quarter.

### Subsidiary Options, Warrants and Stock Activity

During fiscal 2003, Lancer issued 37,595 shares of its common stock valued at \$8,271 to Biomerica for certain management and consulting services rendered in fiscal 2002. These shares were classified at May 31, 2002 as common stock subscribed on Lancer's balance sheet.

During fiscal 2003, Lancer issued 25,000 shares of its common stock valued at \$8,750 to its Chief Executive Officer for services rendered in fiscal 2002. These shares were classified at May 31, 2002 as common stock subscribed on Lancer's balance sheet.

During the year ended May 31, 2003, the Lancer granted 70,000 options to purchase shares of Lancer's common stock at an exercise price of \$0.26 to certain employees of the Lancer for services rendered. The options vest over four years and have a term of five years. Management assigned a value of \$0 to the options.

During the year ended May 31, 2003, Lancer granted 40,000 options to purchase shares of Lancer's common stock at an exercise price of \$0.28 to an employee of Lancer for services rendered. The options vest over four years and have a term of five years. Management assigned a value of \$0 to the options.

12

During the year ended May 31, 2003, Lancer granted 30,000 options to purchase shares of Lancer's common stock at an exercise price of \$0.28 to certain employees of Lancer for services rendered. The options vest over four years and have a term of five years. Management assigned a value of \$0 to the options.

During the year ended May 31, 2004, Lancer granted 120,000 options to purchase shares of Lancer's common stock at an exercise price of \$0.38 per share as pursuant to terms of the employment agreement between Lancer and Dan Castner, the Vice President of Sales and Marketing at Lancer. The options vest over four years and have a term of five years. Management assigned a value of \$0 to the options.

During the year ended May 31, 2004, Lancer granted 52,500 stock options to

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purchase shares of Lancer's common stock at an exercise price of \$0.38 per share to directors of the Lancer for services rendered. The options vest over two years and have a term of five years. Management assigned a value of \$0 to the options.

During the year ended May 31, 2004, Lancer granted 75,000 stock options to purchase shares of Lancer's common stock at an exercise price of \$0.38 per share to its Chief Executive Officer in lieu of salary. The options vest over three years and have a term of five years. Management assigned a value of \$0 to the options.

During the year ended May 31, 2004, Lancer granted 8,000 stock options to purchase shares of Lancer's common stock at an exercise price of \$0.50 to an employee of Lancer for services rendered. The options vest over 3 years beginning June 30, 2004 and have a term of five years. Management assigned a value of \$0 to the options.

During the year ended May 31, 2004, Lancer granted 40,000 stock options to purchase shares of Lancer's common stock at an exercise price of \$0.57 to an employee of Lancer for services rendered. The options vest over four years and have a term of five years. Management assigned a value of \$0 to the options.

During the year ended May 31, 2004, Lancer granted 17,500 stock options to purchase shares of Lancer's common stock at an exercise price of \$0.60 to a new member of its Board of Directors for services to be rendered. The options vest over 2 years and have a term of five years. Management assigned a value of \$0 to the options.

During fiscal 2004, Lancer issued 91,346 shares of its common stock valued at \$29,000 to its Chief Executive Officer for services rendered from January 2002 to December 2003. At May 31, 2003, 69,471 of these shares were reported as subscribed stock.

During fiscal 2004, Lancer agreed to issue 13,541 shares of its common stock to the Chairman of the Board of Lancer for services rendered from January 2004 to May 2004 and 31,250 shares of common stock to the Chief Executive Officer for services rendered per agreement. At May 31, 2004, these shares are reported as subscribed stock.

During fiscal 2004 the Board of Directors of Lancer approved a private offering of common stock, effective March 23, 2004 and ending April 12, 2004. The offering, to officers, board members, and key employees resulted in the sale of 450,000 new shares at \$.60 per share with total proceeds received of \$270,000. In addition, one warrant exercisable for each share purchased (450,000 warrants) was issued at \$.85 per share. These warrants shall be exercisable until April 12, 2009.

(16) Reportable business segments for the quarter ended August 31, 2004 and 2003 are as follows:

	2004	2003
-----		
Domestic sales:		
Orthodontic products	\$ 831,000	\$ 734,000
=====		
Medical diagnostic products	\$ 198,000	\$ 394,000



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=====		
Foreign sales:		
Orthodontic products	\$ 650,000	\$ 584,000
=====		
Medical diagnostic products	\$ 505,000	\$ 452,000
=====		
Net sales:		
Orthodontic products	\$1,481,000	\$ 1,318,000
Medical diagnostic products	703,000	846,000
-----		
Total	\$2,184,000	\$ 2,164,000
=====		
Operating loss:		
Orthodontic products	\$ (81,000)	\$ (146,000)
Medical diagnostic products	(22,000)	(165,000)
-----		
Total	\$ (103,000)	\$ (311,000)
=====		
Operating loss from discontinued segment:		
ReadyScript	--	76
-----		
Total	\$ --	\$ 76
=====		
Domestic long-lived assets:		
Orthodontic products	\$ 498,000	\$ 279,000
Medical diagnostic products	120,000	151,000
-----		
Total	\$ 618,000	\$ 430,000
=====		
Foreign long-lived assets:		
Orthodontic products	\$ 110,500	\$ 86,000
Medical diagnostic products	13,500	18,000
-----		
Total	\$ 124,000	\$ 104,000
=====		
Total assets:		
Orthodontic products	\$4,185,000	\$ 3,502,000
Medical diagnostic products	1,464,000	1,879,000
-----		
Total	\$5,649,000	\$ 5,381,000
=====		
Depreciation and amortization expense:		
Orthodontic products	\$ 26,000	\$ 12,000
Medical diagnostic products	20,000	15,000
-----		

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Total	\$ 46,000	\$ 27,000

14

Capital expenditures:		
Orthodontic products	\$ 62,000	\$ 147,000
Medical diagnostic products	--	18,000
Total	\$ 62,000	\$ 165,000

The net sales as reflected above consist of sales of unaffiliated customers only as there were no significant intersegment sales during the quarter ended August 31, 2004 and 2003.

(17) Pursuant to the terms of the employment agreement between Lancer and Dan Castner, the Vice President of Sales and Marketing of Lancer, dated May 20, 2003, Lancer agreed to pay Mr. Castner an annual base salary of \$135,000. In addition, Lancer granted Mr. Castner stock options on June 2, 2003, to purchase an aggregate of 120,000 shares of Lancer's common stock at an exercise price of \$0.38 per share. The stock options have a term of five years and will vest over four years as follows: (i) 25% vesting on the first anniversary of the date of grant; (ii) 25% vesting on the second anniversary of the date of grant; (iii) the remaining 50% vesting as to one-twenty fourth (1/24th) per month each month thereafter for the next two years. Should Lancer be purchased by an affiliated third party, the options shall vest 100%.

(18) In April 2003, Lancer de Mexico entered into a manufacturing subcontractor agreement with Biomerica, Inc., to provide manufacturing services in Mexicali, Mexico. The agreement requires reimbursement from Biomerica for discrete expenses such as payroll, shipping, and customs fees; lease and security deposits of approximately \$2,000 and \$1,100 per month, respectively; and service fees of approximately \$2,900 per month.

(19) Under its bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer or director's serving in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. However, the Company has a directors and officer liability insurance policy that limits its exposure and enables it to recover a portion of any future amounts paid.

As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal and has no liabilities recorded for these agreements as of August 31, 2003. The Company enters into indemnification provisions under (i) its agreements with other companies in its ordinary course of business, typically with business partners, contractors, and customers, landlords and (ii) its agreements with investors. Under these provisions the Company generally indemnifies and hold harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company's activities or, in some cases, as a result of the indemnified party's activities under the agreement. These indemnification provisions often include indemnifications relating to representations made by the Company with regard to intellectual property rights. These indemnification provisions generally survive termination of the underlying agreement. In addition, in some cases, the Company has agreed to reimburse employees for

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certain expenses and to provide salary continuation during short-term disability. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of August 31, 2004.

15

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND SELECTED FINANCIAL DATA

CERTAIN INFORMATION CONTAINED HEREIN (AS WELL AS INFORMATION INCLUDED IN ORAL STATEMENTS OR OTHER WRITTEN STATEMENTS MADE OR TO BE MADE BY BIOMERICA) CONTAINS STATEMENTS THAT ARE FORWARD-LOOKING, SUCH AS STATEMENTS RELATING TO ANTICIPATED FUTURE REVENUES OF THE COMPANY AND SUCCESS OR CURRENT PRODUCT OFFERINGS. SUCH FORWARD-LOOKING INFORMATION INVOLVES IMPORTANT RISKS AND UNCERTAINTIES THAT COULD SIGNIFICANTLY AFFECT ANTICIPATED RESULTS IN THE FUTURE, AND ACCORDINGLY, SUCH RESULTS MAY DIFFER MATERIALLY FROM THOSE EXPRESSED IN ANY FORWARD-LOOKING STATEMENTS MADE BY OR ON BEHALF OF BIOMERICA. THE POTENTIAL RISKS AND UNCERTAINTIES INCLUDE, AMONG OTHERS, FLUCTUATIONS IN THE COMPANY'S OPERATING RESULTS. THESE RISKS AND UNCERTAINTIES ALSO INCLUDE THE SUCCESS OF THE COMPANY IN RAISING NEEDED CAPITAL, THE ABILITY OF THE COMPANY TO MAINTAIN REQUIREMENTS TO BE LISTED ON NASDAQ, THE CONTINUAL DEMAND FOR THE COMPANY'S PRODUCTS, COMPETITIVE AND ECONOMIC FACTORS OF THE MARKETPLACE, AVAILABILITY OF RAW MATERIALS, HEALTH CARE REGULATIONS AND THE STATE OF THE ECONOMY. READERS ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON THESE FORWARD-LOOKING STATEMENTS, WHICH SPEAK ONLY AS OF THE DATE HEREOF, AND THE COMPANY UNDERTAKES NO OBLIGATION TO UPDATE THESE FORWARD-LOOKING STATEMENTS.

#### RESULTS OF OPERATIONS

Consolidated net sales for Biomerica were \$2,184,437 for the first quarter of fiscal 2005 as compared to \$2,164,360 for the same period in the previous year. This represents an increase of \$20,077, or 0.9%. Of the total consolidated net sales for fiscal 2004, \$1,480,863 is attributable to Lancer, and \$703,574 to Biomerica. Lancer sales increased by \$162,756 over the previous fiscal year. International sales at Lancer increased \$66,183 primarily in Europe and the Middle East. Domestic sales at Lancer increased \$96,573, primarily due to a price increase. Biomerica sales decreased by \$142,679 primarily due a large sale of EZ Detect in fiscal 2004, which did not occur in fiscal 2005.

Cost of sales as a percentage of sales decreased from 69.5% to 69.0%. Lancer's cost of sales as a percentage of sales decreased from 74.0% to 72.4%. This decrease was attributable to the price increase domestically. Biomerica's costs increased from 67.9% of sales to 62.9% due to a change in the product mix which was offset by lower costs from the establishment of the Mexicali manufacturing facility.

Selling, general and administrative costs decreased by \$187,486, or 20.9%. Lancer had increased selling, general and administrative costs of \$6,581 primarily due to the cost of stock issued to officers in lieu of salary. Biomerica had a decrease of \$147,701, which was due to higher commissions during fiscal 2004 associated with a large EZ Detect sale, as well as compensation expense recorded in connection the issuance of common stock and warrants to employees in the prior fiscal year.

Research and development decreased by \$3,291, or 4.4%. Lancer had a

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decrease in research and development costs of \$5,394 due to completion of projects started in the prior fiscal year. Biomerica had increased costs of \$2,103 primarily due to higher wages and related costs.

For the three months ended August 31, 2004, other income of \$13,435 was realized as compared to other expense of \$7,011 in the prior year, which was a result of insurance premium refunds and a decrease in financing costs at Lancer.

Interest expense decreased from \$10,462 to \$8,118 due to no interest expense incurred at Lancer and lower principal balance on notes and loans payable at Biomerica.

Please refer to Note 3 in the Notes to the Consolidated Financial Statements in the Company's report on Form 10-KSB for the year ended May 31, 2004, for a more in-depth discussion of subsidiaries.

### LIQUIDITY AND CAPITAL RESOURCES

As of August 31, 2004, the Company had cash and available-for-sale securities in the amount of \$161,645 and working capital of \$2,596,114. Cash and working capital totaling \$126,905 and \$2,746,045, respectively, relates to the Lancer subsidiary. Lancer's line of credit restricts Biomerica's ability to draw on Lancer's resources and, as such, said cash, working capital and equity are not available to Biomerica.

16

The Company has suffered substantial recurring losses from operations over the last few years. The Company has funded its operations through debt and equity financings, and may have to do so in the future. ReadyScript operations were discontinued in May 2001 and Allergy Immuno Technologies was sold in May 2002. ReadyScript and Allergy Immuno Technologies were previously contributors to the Company's losses. The Company has reduced operating costs through certain cost reduction efforts and plans to concentrate on its core business in Lancer and Biomerica to increase sales. There can be no assurance that the Company will be able to become profitable, generate positive cash flow from operations, increase sale, or obtain the necessary equity or debt financing to fund operations in the future. Should the Company be unable to reduce costs adequately, secure additional financing, or increase sale, the result for the Company could be the inability to continue as a going concern.

The Company will continue to have limited cash resources. Although the Company's management recognizes the imminent need to secure additional financing or increase sales there can be no assurance that the Company will be successful in consummating any such transaction or, if the Company does consummate such transaction, that the terms and conditions of such financing will not be unfavorable to us.

Our independent certified public accountants have concluded that these factors, among others, raises substantial doubt as to the Company's ability to continue as a going concern for a reasonable period of time, and have, therefore modified their audit report on the Company's annual consolidated financial statements as of and for the year ended May 31, 2004 in the form of an explanatory paragraph describing the events that have given rise to this uncertainty. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

These consolidated financial statements have been prepared assuming that the

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Company will continue as a going concern. The Company has operating and liquidity concerns due to historically reporting net losses and negative cash flows from operations. Biomerica's shareholder's line of credit, which allowed for a shareholder of the Company to loan to the Company, as needed, up to \$500,000 for working capital needs, expired September 13, 2003. In March 2004 the Company signed a note payable for the principal and interest due at that time of \$313,318 and agreed to a forbearance of any payments for the length of the agreement. A warrant for 40,000 shares of restricted common stock exercisable at a price of \$0.51 per share was awarded as compensation for the forbearance. The note payable is secured by all the Company's assets except for the Lancer common stock owned by Biomerica. The note was due September 1, 2004. Currently, the Company is finalizing an agreement whereby monthly payments will be made on the note and extending the due date of the note for one year.

During the quarter ended August 31, 2004, the Company operations used cash of \$174,242. This compares to cash provided by operations of \$127,671 in the same period in the prior fiscal year. Of this there was cash used in operations of \$115,654 and \$72,243 at the Lancer subsidiary for the period ended August 31, 2004 compared to 2003. Cash provided by financing activities was \$22,500 as compared to \$69,210 in the prior fiscal year, which resulted from a change in minority interest of \$22,500.

Pursuant to a decision by the Nasdaq Listing Qualifications Panel, the Company's common stock was delisted from the Nasdaq Stock Market effective June 20, 2002, for failure to comply with the net tangible assets or shareholders' equity requirements as set forth in Marketplace Rule 4310(c)(2)(B). The Company's securities were immediately eligible to trade on the OTC Bulletin Board and are traded under the symbol BMRA.OB.

At August 31, 2004, Lancer had a \$400,000 line of credit with Cuyamaca Bank, through January 8, 2005. Borrowings are made at prime plus 2.0% (6.5% at August 31, 2004) and are limited to 80% of accounts receivable less than 90 days old. The outstanding balance at August 31, 2004 was \$0 and the unused portion available was approximately \$340,000 as Lancer requested that Cuyamaca Bank reserve \$60,000 of the available line of credit as a guarantee of credit with a European supplier.

The line of credit is collateralized by substantially all the assets of Lancer, including inventories, receivables, and equipment. The lending agreement for the line of credit requires, among other things, that Lancer maintain a balance sheet net worth ratio of \$2,700,000 and that a zero outstanding balance be maintained for 30 consecutive days during the term. Proceeds from this line cannot be used to support the operations of Biomerica. Lancer is in compliance with its debt covenants at August 31, 2004.

17

### CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial condition and results of operations are based on the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. Note 2 of the Notes to Consolidated Financial Statements contained in the Company's annual report on Form 10KSB for the period ended May 31, 2004, describes the significant accounting policies essential to the consolidated financial statements. The preparation of these financial statements requires estimates and assumptions that affect the reported amounts and disclosures.

We believe the following to be critical accounting policies as they require

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more significant judgments and estimates used in the preparation of our consolidated financial statements. Although we believe that our judgments and estimates are appropriate and correct, actual future results may differ from our estimates.

In general the critical accounting policies that may require judgments or estimates relate specifically to the Allowance for Doubtful Accounts, Inventory Reserves for Obsolescence and Declines in Market Value, Impairment of Long-Lived Assets, Stock Based Compensation and Income Tax Accruals.

We recognize product revenues when an arrangement exists, delivery has occurred, the price is determinable and collection is reasonably assured.

The Allowance for Doubtful Accounts is established for estimated losses resulting from the inability of our customers to make required payments. The assessment of specific receivable balances and required reserves is performed by management and discussed with the audit committee. We have identified specific customers where collection is probably and have established specific reserves, but to the extent collection is made, the allowance will be released. Additionally, if the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Reserves are provided for excess and obsolete inventory, which are estimated based on a comparison of the quantity and cost of inventory on hand to management's forecast of customer demand. Customer demand is dependent on many factors and requires us to use significant judgment in our forecasting process. We must also make assumptions regarding the rate at which new products will be accepted in the marketplace and at which customers will transition from older products to newer products. Once a reserve is established, it is maintained until the product to which it relates is sold or otherwise disposed of, even if in subsequent periods we forecast demand for the product.

In general, we are in a loss position for tax purposes, and have established a valuation allowance against deferred tax assets, as we do not believe it is likely that we will generate sufficient taxable income in future periods to realize the benefit of our deferred tax assets. Predicting future taxable income is difficult, and requires the use of significant judgment. At August 31, 2004, all of our deferred tax assets were reserved. Accruals are made for specific tax exposures and are generally not material to our operating results or financial position, nor do we anticipate material changes to these reserves in the near future.

Please refer to the annual report on Form 10-KSB for the period ended May 31, 2004 for an in-depth discussion of risk factors.

### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

You should read the following factors in conjunction with the factors discussed elsewhere in this and our other filings with the SEC and in materials incorporated by reference in these filings. The following is intended to highlight certain factors that may affect the financial condition and results of operations of Biomerica and are not meant to be an exhaustive discussion of risks that apply to companies such as Biomerica. Like other businesses, Biomerica is susceptible to macroeconomic downturns in the United States or abroad, that may affect the general economic climate and performance of Biomerica or its' customers. Aside from general macroeconomic downturns, the additional material factors that could affect future financial results include, but are not limited to: Terrorist attacks and the impact of such events; diminished access to raw materials that directly enter into our manufacturing process; shipping labor disruption or other major degradation of the ability to ship our products to end users; inability to successfully control our margins

which are affected by many factors including competition and product mix; protracted shutdown of the U.S. Border due to an escalation of terrorist or counter terrorist activity; any changes in our business relationships with international distributors or the economic climate they operate in; any event that has a material adverse impact on our foreign manufacturing operations may adversely affect our operation as a whole; failure to manage the future expansion of our business could have an adverse affect on our revenues and profitability; possible costs in complying with government regulations and the delays in receiving required regulatory approvals or the enactment of new adverse regulations or regulatory requirements; numerous competitors, most of which have substantially greater financial and other resources than we do; potential claims and litigation brought by patients or medical professionals alleging harm caused by the use of or exposure to our products; quarterly variations in operating results caused by a number of factors, including business and industry conditions and other factors beyond our control. All of these factors make it difficult to predict operating results for any particular period.

Item 4. CONTROLS AND PROCEDURES

The Company's Chief Executive Officer and Chief Financial Officer (the Company's principal executive officer and principal financial officer, respectively) have concluded, based on their evaluation as of August 31, 2004, that the design and operation of the Company's "disclosure controls and procedures" (as defined in rules 13a-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act")) are effective to ensure that information required to be disclosed by the Company in the reports filed or submitted by the Company under the Exchange Act is accumulated, recorded, processed, summarized and reported to the Company's management, including the Company's principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding whether or not disclosure is required.

During the quarter ended August 31, 2004, there were no changes in the Company's "internal controls over financial reporting" (as defined in Rule 13a-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II. OTHER INFORMATION

- Item 1. LEGAL PROCEEDINGS. Inapplicable.
- Item 2. CHANGES IN SECURITIES AND USE OF PROCEEDS. Inapplicable.
- Item 3. DEFAULTS UPON SENIOR SECURITIES. Inapplicable.
- Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS. Inapplicable.
- Item 5. OTHER INFORMATION. Inapplicable.

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Item 6. EXHIBITS AND REPORTS ON FORM 8-K. No reports on Form 8-K were filed in the year ended May 31, 2004. Biomerica filed a report on Form 8-K/A with the Securities and Exchange Commission on June 7, 2004. Lancer filed a report on Form 8-K June 8, 2004. Both reports were filed to report a change in independent accountants. Subsequent to the quarter ended August 31, 2004 both Biomerica and Lancer filed a Form 8-K on September 24, 2004 regarding the departure of Dr. Robert Orlando from the Board of Directors.

(a) Exhibits

99.1 Certifications of Chief Executive Officer and Chief Financial Officer pursuant To 18 U.S.C., Section 1350, as adopted pursuant to Section 302 and 906 of the Sarbanes-Oxley Act of 2002.

20

SIGNATURES

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

Date: October 15, 2004

BIOMERICA, INC.

By: /S/ Zackary S. Irani

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Zackary S. Irani  
Chief Executive Officer

21