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BIOMERICA INC  
Form 10QSB  
April 14, 2005

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 February 28, 2005  
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Commission File No. 0-8765  
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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 April 14, 2005.

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BIOMERICA, INC.

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### PART I - FINANCIAL INFORMATION

#### SUMMARIZED FINANCIAL INFORMATION ITEM 1. FINANCIAL STATEMENTS

BIOMERICA, INC.

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CONSOLIDATED STATEMENTS OF OPERATIONS  
AND COMPREHENSIVE LOSS (UNAUDITED)

	Nine Months Ended	
	February 28, 2005	February 29, 2004
	-----	-----
Net sales .....	\$ 6,691,509	\$ 6,899,088
Cost of sales .....	(4,461,838)	(4,784,264)
Gross profit .....	\$ 2,229,671	\$ 2,114,824
	-----	-----
Operating Expenses:		
Selling, general and administrative .....	2,195,439	2,250,086
Research and development .....	203,816	207,123
	-----	-----
	2,399,255	2,457,209
	-----	-----
Operating loss from continuing operations .....	(169,584)	(342,385)
	-----	-----
Other Expense (income):		
Interest expense .....	28,692	24,120
Other (income) expense, net .....	(19,501)	(54,514)
	-----	-----
	9,191	(30,394)
	-----	-----
(Loss) gain from continuing operations, before minority interest in net (loss) gain of consolidated subsidiary and income taxes .....	(178,775)	(311,991)
Minority interest in net (loss) gain of consolidated subsidiary .....	(127,270)	(48,069)
	-----	-----
(Loss) gain from continuing operations, before income taxes ....	(51,505)	(263,922)
Income tax expense .....	1,938	26
	-----	-----
Net (loss) gain from continuing operations .....	(53,443)	(263,948)

The accompanying notes are an integral part of these statements.

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	2005	2004
	-----	-----
Discontinued operations:		
Gain (loss) income from discontinued operations, net .....	6,600	(4,359)
	-----	-----
Net (loss) gain .....	(46,843)	(268,307)
Other comprehensive (loss) gain, net of tax		
Unrealized (loss) gain on available-for-sale securities .....	(12,904)	35,580
	-----	-----
Comprehensive (loss) gain .....	\$ (59,747)	\$ (232,727)
	=====	=====
Basic net (loss) gain per common share:		
Net (loss) gain from continuing operations .....	\$ (.01)	\$ (.05)
Net gain (loss) from discontinued operations .....	.00	(.00)
	-----	-----
Basic net (loss) gain per common share .....	\$ (.01)	\$ (.05)
	=====	=====
Diluted net (loss) gain per common share		
Net (loss) gain from continuing operations .....	\$ (.01)	\$ (.05)
Net loss from discontinued operations .....	.00	(.00)
	-----	-----
Diluted net (loss) gain per common share .....	\$ (.01)	\$ (.05)
	=====	=====
Weighted average number of common and common equivalent shares:		
Basic .....	5,752,431	5,726,993
Diluted .....	5,752,431	5,726,993
	=====	=====

The accompanying notes are an integral part of these statements

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BIOMERICA, INC.

CONSOLIDATED BALANCE SHEET (UNAUDITED)

	February 28, 2005
	-----
Assets	
Current Assets	
Cash and cash equivalents .....	\$ 221,046
Available for-sale securities .....	13,216
Accounts receivable, less allowance for doubtful accounts of \$110,988 .....	1,759,797
Inventories, net of reserve of \$281,193 .....	2,837,486

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Notes receivable .....	2,919
Prepaid expenses and other .....	120,220
	-----
Total Current Assets .....	4,954,684
Inventory, non-current .....	18,000
Property and Equipment, net of accumulated depreciation and amortization .....	789,772
Intangible assets, net of accumulated amortization .....	14,860
Other Assets .....	62,240
	-----
	\$5,839,556
	=====

The accompanying notes are an integral part of these statements

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BIOMERICA, INC.

CONSOLIDATED BALANCE SHEET - Continued (UNAUDITED)

	February 28, 2005
	-----
Liabilities and Shareholders' Equity	
Current Liabilities	
Line of credit .....	\$ 195,415
Accounts payable and accrued liabilities .....	1,109,551
Accrued compensation .....	548,632
Shareholder loan .....	317,318
Net liabilities from discontinued operations .....	271,951
	-----
Total Current Liabilities .....	2,442,867
Minority interest .....	2,546,323
	-----
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 .....	17,108,845
Accumulated other comprehensive gain .....	5,562
Accumulated deficit .....	(16,724,234)
	-----
Total Shareholders' Equity .....	850,366
	-----

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Total Liabilities and Equity ..... \$ 5,839,556  
=====

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BIOMERICA, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

For the nine months ended	February 28, 2005	February 2004
	-----	-----
Cash flows from operating activities:		
Net loss from continuing operations .....	\$ (53,443)	\$ (263,948)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization .....	120,747	95,075
Realized gain on sale of available-for-sale security .....	(8,888)	15,115
Minority interest in net (loss) gain of consolidated subsidiary ...	(127,270)	(48,069)
Common stock, warrants and options issued for services rendered ...	10,400	55,172
Common stock issued by subsidiary for services rendered .....	58,250	--
Provision for losses on accounts receivable .....	(61,414)	45,663
Warrant and options issued for services rendered .....	312	--
Loss on disposal of fixed assets .....	1,258	--
Changes in current assets and liabilities:		
Accounts Receivable .....	(181,100)	(128,705)
Inventories .....	(162,643)	12,737
Prepaid expenses and other current assets .....	58,622	15,094
Accounts payable and other accrued liabilities .....	126,772	(75,116)
Accrued compensation .....	82,709	129,811
	-----	-----
Net cash used in operating activities .....	(135,688)	(147,171)
	-----	-----
Cash flows from investing activities:		
Purchases of property and equipment .....	(177,950)	(339,016)
Other assets .....	(13,419)	(19,504)
	-----	-----
Net cash used in investing activities .....	(191,369)	(358,520)
	-----	-----
Cash flows from financing activities:		
Sale of available for sale securities .....	8,888	--
Issuance of shares by subsidiary .....	--	7,750
Increase in shareholder loan .....	--	2,666
Private placement, net of offering costs .....	--	50,500
Exercise of stock options at subsidiary .....	1,170	2,000
Increase (decrease) in line of credit .....	195,415	(426)
Increase in term loan .....	--	97,931
	-----	-----
Net cash provided by financing activities .....	205,473	160,421
	-----	-----

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Net cash used in discontinued operations .....	(9,744)	(974)
	-----	-----
Net (decrease) in cash and cash equivalents .....	(131,328)	(346,244)
Cash at beginning of period .....	352,374	525,167
	-----	-----
Cash at end of period .....	\$ 221,046	\$ 178,923
	=====	=====
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 .....	(26,872)	--
	=====	=====

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 NINE MONTHS ENDED February 28, 2005

	Common Stock			Accumulated		
	Number	Amount	Additional	Other	Accumulated	To
	of		Paid-in	Comprehensive	Deficit	Total
	Shares		Capital	Gain (loss)		
	-----	-----	-----	-----	-----	-----
Balance at May 31, 2004	5,752,431	\$ 460,193	\$17,125,005	\$ 18,466	\$ (16,677,391)	\$ 92,603
Change in unrealized gain on available for sale securities				(12,904)		(12,904)
Expense related to issuance of warrants for extension of note			10,400			10,400
Compensation expense in connection with options and warrants issued			312			312
Issuance of stock at subsidiary			(26,872)			(26,872)
Net loss					(46,843)	(46,843)
	-----	-----	-----	-----	-----	-----
Balance at February 28, 2005	5,752,431	\$ 460,193	\$17,108,845	\$ 5,562	\$ (16,724,234)	\$ 85,766
	=====	=====	=====	=====	=====	=====

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The accompanying notes are an integral part of these statements.

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### NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

February 28, 2005

- (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.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP"), requires management 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 consolidated financial statements, and the reported amounts of revenues and expenses during the reported period. Significant estimates made by Biomerica's and Lancer's management include, but are not limited to, allowances for doubtful accounts, allowances for sales returns, valuation of inventories, realizability of property and equipment through future operations and realizability of deferred tax assets. Actual results could materially differ from those estimates.

- (2) As of February 28, 2005, the Company had cash and available-for-sale securities in the amount of \$234,262 and working capital of \$2,511,817. Cash and working capital totaling \$203,408 and \$2,631,992, 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 couple of years. Biomerica 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, Inc. 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 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 new or additional debt financing. The Company is currently in negotiations to obtain a line of credit for product acquisition financing. However, this line of credit would not be



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available for general operations. Although the Company's management recognizes the imminent need to secure additional financing 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 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 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.

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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 \$104 interest payable under this note payable at February 28, 2005. On November 19, 2004, the Company entered into an agreement entitled "Amendment of the Note, Loan and Modification Agreement". This amends the "Loan Modification, Forbearance and Security Agreement" and "Amended and Restated Promissory Note" which were included as exhibits to the Form 10QSB filed April 14, 2004. The Amendment of the Note, Loan and Modification Agreement was filed as an exhibit to a Form 8K filed November 24, 2004. The agreement extends the maturity date of the note until August 31, 2005 and allows for minimum payments of \$4,000 per month and additional contingent payments of up to \$3,500 per month based on the Company's quarterly performance. Collateral remains the same under the amendment.

- (3) In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosures - 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 implementation of SFAS No. 148 did not have a material effect on the Company's consolidated financial position or results of operation.

In December 2004, FASB issued SFAS No. 123 (revised 2004) "Share Based Payments" (SFAS No. 132R), a revision to Statement No. 123, Accounting for Stock-Based Compensation which supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. The revised SFAS 123 eliminates

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the alternative to use Opinion 25's intrinsic value method of accounting, and instead, requires entities to recognize the costs of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards. Furthermore, public entities are required to measure liabilities incurred to employees in share-based payment transactions at fair value as well as estimate the number of instruments for which the requisite service is expected to be rendered. Any incremental compensation cost for a modification of the terms or conditions of an award is measured by comparing the fair values before and after the modification. The Company has yet to determine the effect SFAS No. 123R may have in its financial statements, if any.

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 fair value at the date of grant consistent with the provisions of SFAS 148, for the quarter ended February 28 is as follows:

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	Nine Months Ended		Three Months Ended	
	2/28/05	2/29/04	2/28/05	2/29/04
Net (loss) gain from continuing operations, as reported	\$ (53,443)	\$ (263,948)	\$ 72,136	\$ 64,591
Plus: Stock-based employee compensation expense included in reported net gain (loss)	312	55,172	69	9,684
Less: Stock-based employee compensation expense determined using fair value based method	(22,960)	(18,918)	(8,731)	(6,269)
Net (loss) gain from continuing operations, pro forma	\$ (76,091)	\$ (227,694)	\$ 63,474	\$ 68,006
Pro forma net (loss) gain from continuing operations per share - basic	\$ (.01)	\$ (0.04)	\$ .01	\$ .01
Pro forma net (loss) gain from continuing operations per share - diluted	\$ (.01)	\$ (0.04)	\$ .01	\$ .01

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- (4) The following summary presents the options granted, exercised, expired, and outstanding as of February 28, 2005:

	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	155,000	14,000	169,000	.33
Exercised	--	--	--	--
Expired	(72,000)	(1,048,000)	(1,120,000)	2.96
Cancelled	--	--	--	--
	-----	-----	-----	-----
Outstanding				
February 28, 2005	2,511,808	194,829	2,706,637	\$ 1.80
	=====	=====	=====	=====

- (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. Please see the Company's Annual Report on Form 10-KSB for the fiscal year ended May 31, 2004 for more detailed footnotes.
- (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 \$5,562 at February 28, 2005.

- (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 entities with complex capital structures.

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Basic EPS is computed as net income divided by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock options, warrants and other convertible securities.

The following table illustrates the required disclosure of the reconciliation of the numerators and denominators of the basic and diluted EPS computations.

For the Nine Months Ended February 28, 2005			
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS -			
Loss from continuing operations .....	\$ (53,443)	-	\$ (.01)
Gain (loss) from discontinued operations .....	6,600	-	.00
	\$ (46,843)	5,752,431	\$ (.01)
Diluted EPS -			
Loss attributable to common share - holders .....	\$ (46,843)	5,752,431	\$ (.01)
For the Nine Months Ended February 29, 2004			
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS -			
Loss from continuing operations .....	\$ (263,948)	-	\$ (.05)
Gain (loss) from discontinued operations .....	(4,359)	-	(.00)
	\$ (268,307)	5,726,993	\$ (.05)
Diluted EPS -			
Loss attributable to common share - holders .....	\$ (268,307)	5,726,993	\$ (.05)
For the Three Months Ended February 28, 2005			
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS -			
Gain (loss) from continuing operations .....	\$ 72,136	-	\$ .01
Gain (loss) from discontinued operations .....	-	-	.00
	\$ 72,136	5,752,431	\$ .01
Diluted EPS -			
Weighted average number of common and common equivalent shares used for calculating			

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diluted EPS .....	-	5,752,431	-
Weighted average number of dilutive common and common equivalent shares used for calculating diluted EPS .....	-	815,690	-
Gain attributable to common shareholders .....	\$ 72,136	6,568,121	\$ .01

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	For the Three Months Ended February 29, 2004		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS -			
Loss from continuing operations .....	\$ 64,591	-	\$ .01
Gain (loss) from discontinued operations .....	(1,415)	-	(.00)
	\$ 63,176	5,258,475	\$ .01
Diluted EPS -			
Weighted average number of common and common equivalent shares used for calculating Basic EPS .....	-	5,258,475	-
Weighted average number of dilutive Common and common equivalent shares Used for calculating diluted EPS .....	-	-	-
Gain attributable to common shareholders .....	\$ 63,176	5,258,475	\$ .01

The computation of diluted loss per share excludes the effect of incremental common shares attributable to the exercise of outstanding common stock options and warrants because their effect was antidilutive due to losses incurred by the Company.

As of February 28, 2005, there was a total of 815,690 potential dilutive shares of common stock outstanding.

- (11) In October 2001, the FASB issued SFAS No. 144, "Accounting for the 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

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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.

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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

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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 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.

In April 2003, SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" was issued. 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 SFAS 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, SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" was issued. This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. This statement is effective for financial instruments entered into or modified after May 31, 2003. The adoption of SFAS No. 150 did not have a significant effect on the Company's consolidated financial position, results of operations, or cash flows.

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

	For the Nine Months Ended	
	2/28/05	2/29/04
	-----	-----
Revenues from sales to unaffiliated customers:		
United States	\$2,915,000	\$3,229,000
Asia	184,000	157,000
Europe	2,065,000	2,063,000
South America	299,000	330,000
Oceania	493,000	377,000
Other	736,000	743,000
	\$6,692,000	\$6,899,000

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

On January 13, 2005 Lancer filed a Form 15-12g (Certification and Notice of Termination of Registration under Section 12(g) of the Securities Exchange Act of 1934 or Suspension of Duty to File Reports under Sections 13 and 15(d) of the Securities Exchange Act of 1934. Lancer's duty to file reports with the Securities and Exchange Commission has terminated or suspended according to Rule 12g-4(a)(1)(i) & (ii) and Rule 12h-3(b)(1)(i) & (ii). Lancer's stock is now traded on the pink sheets under the symbol LANZ.

- (14) At February 28, 2005, Lancer has a \$400,000 line of credit with Community National Bank (formerly Cuyamaca Bank). Borrowings are made at prime plus 2.0% (7.50% at February 28, 2005), and are limited to 80% of domestic accounts receivable less than 90 days old. The outstanding balance at February 28, 2005 was \$195,415 and the unused portion available was approximately \$144,585. Lancer requested that Community National Bank reserve \$60,000 of its available Credit line as a guarantee of credit with a European supplier. Lancer was in compliance with its debt covenants at February 28, 2005.

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 tangible net worth ratio of \$2,700,000 and a zero balance be maintained for 30 consecutive days during the term. Lancer is not required to maintain compensating balances in connection with this lending agreement. Proceeds from this line cannot be used to support the operations of Biomerica.

The Lancer line of credit expired January 8, 2005 and was renewed until October 15, 2005.

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.

On November 19, 2004, the Company entered into an Agreement entitled "Amendment of the Note, Loan and Modification Agreement". This amends the "Loan Modification, Forbearance and Security Agreement" and "Amended and Restated Promissory Note" which were included as exhibits to the Form 10QSB filed April 14, 2004. The Amendment of the Note, Loan and Modification Agreement was filed as an exhibit to a Form 8K filed November 24, 2004. The agreement extends the maturity date of the note until August 31, 2005 and allows for minimum payments of \$4,000 per month and additional contingent payments of up to \$3,500 per month based on the Company's quarterly performance. Collateral remains the same under the amendment. There was \$313,318 of outstanding principal and \$104 interest payable under this note payable at February 28, 2005.



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- (15) During fiscal 2005, Biomerica granted 169,000 stock options to purchase shares of common stock at an exercise price of \$0.33 to select employees and consultants of the Company. The options vest over four years, and have a term of five years. Management assigned a value of \$3,500 to these options. These options were granted under the Company's existing 1995 and 1999 Stock Option and Restricted Stock Plan. During the quarter ended February 28, 2005 the Company has recognized an expense of \$234 attributable to these options, with the remaining value of these options to be amortized over the options vesting period.

During fiscal 2004, the Company sold 202,000 shares of restricted common stock in a private placement to insiders and qualified investors at a selling price of \$.25 per share. Warrants to purchase 202,000 shares of the Company's restricted common stock at an exercise price of \$.25 were also granted as part of the private placement. During the three months ended August 31, 2003, \$48,080 was recorded as compensation expense for the excess in the market value of the issued common stock and warrants over the consideration received. The warrants vest immediately, expire in five years, and are exercisable at \$.25 per share.

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During fiscal 2004, the Company issued 10,000 shares of its common stock as the result of the 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 in 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.

During the quarter ended November 30, 2004, the Company recognized a reduction in its additional paid in capital in the amount of \$11,413 resulting from a decrease in its ownership percentage of Lancer as a result of Lancer issuing shares of Common stock during the quarter.

During the quarter ended February 28, 2005, the Company recognized a reduction in its additional paid in capital in the amount of \$11,359 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 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.

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

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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.

During fiscal 2005, the Board of Directors of Lancer approved the issuance of 6,972 shares of common stock to a consultant.

During fiscal 2005, the Board of Directors of Lancer granted 27,500 stock options to purchase shares of Lancer's common stock at an exercise price of \$.75 to certain employees of Lancer for services rendered. The options vest over four years and have a term of ten years. Management assigned a value of \$0 to the options.

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During fiscal 2005, the Board of Directors of Lancer approved the issuance of 62,500 shares of its restricted common stock valued at \$37,500 to its Chief Executive Officer for services rendered during the current fiscal year. An additional 20,000 shares have been accrued as common stock subscribed. During fiscal 2005 14,584 shares have been accrued for the Chairman as common stock subscribed.

During fiscal 2005, the Board of Directors of Lancer granted 100,000 stock options to purchase shares of Lancer's common stock at an exercise price of \$.70 to Lancer's President, Dan Castner. The options expire February 1, 2010 and vest 4,167 shares on the first day of each calendar month he is employed by Lancer, commencing March 1, 2005. Management assigned a value of \$0 to the options.

During fiscal 2005, an employee at Lancer exercised a stock option for 4,500 shares at the purchase price of \$.26 per share. Proceeds to Lancer were \$1,170.

- (16) Reportable business segments for the nine months and quarter ended February 28, 2005 and February 29, 2004 are as follows:

	Nine Months Ended		Three Months Ended	
	February 28, 2005	February 29, 2004	February 28, 2005	February 29, 2004
-----				
Domestic sales:				
Orthodontic products	\$2,245,000	\$2,351,000	\$ 682,000	\$ 833,000
=====				
Medical diagnostic products	\$ 670,000	\$ 878,000	\$ 271,000	\$ 228,000
=====				
Foreign sales:				
Orthodontic products	\$2,117,000	\$2,172,000	\$ 789,000	\$ 806,000
=====				
Medical diagnostic products	\$1,660,000	\$1,498,000	\$ 603,000	\$ 598,000
=====				
-----				
	Nine Months Ended		Three Months Ended	
	February 28, 2005	February 29, 2004	February 28, 2005	February 29, 2004
-----				
Net sales:				
Orthodontic products	\$4,362,000	\$4,523,000	\$1,471,000	\$1,639,000
Medical diagnostic products	2,330,000	2,376,000	874,000	826,000
-----				
Total	\$6,692,000	\$6,899,000	\$2,345,000	\$2,465,000
=====				
Operating (loss) income:				
Orthodontic products	\$ (198,000)	\$ (92,000)	\$ (37,000)	\$ 56,000
Medical diagnostic products	28,000	(250,000)	97,000	42,000
-----				
Total	\$ (170,000)	\$ (342,000)	\$ 60,000	\$ (98,000)
=====				

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Operating gain (loss) from discontinued Segment: ReadyScript	\$ 6,600	\$ (4,359)	\$ 0	\$ (1,415)
-----				
Total	\$ 6,600	\$ (4,359)	\$ 0	\$ (1,415)
=====				
Depreciation and amortization expense:				
Orthodontic products	\$ 70,000	\$ 48,000	\$ 20,000	\$ 22,000
Medical diagnostic products	51,000	44,000	16,000	11,000
-----				
Total	\$ 121,000	\$ 92,000	\$ 36,000	\$ 33,000
=====				
Domestic long-lived assets:				
Orthodontic products	\$ 555,000	\$ 387,000		
Medical diagnostic products	118,000	134,000		
-----				
Total	\$ 673,000	\$ 521,000		
=====				
Foreign long-lived assets:				
Orthodontic products	\$ 102,000	\$ 121,000		
Medical diagnostic products	15,000	17,000		
-----				
Total	\$ 117,000	\$ 659,000		
=====				
Total assets:				
Orthodontic products	\$4,208,000	\$3,837,000		
Medical diagnostic products	1,632,000	1,704,000		
-----				
Total	\$5,840,000	\$5,541,000		
=====				
Capital expenditures:				
Orthodontic products	\$ 149,000	\$ 297,000		
Medical diagnostic products	29,000	18,000		
-----				
Total	\$ 178,000	\$ 315,000		
=====				

The net sales as reflected above consist of sales of unaffiliated customers only as there were no significant intersegment sales during the quarter ended and nine months ended February 28, 2005 and February 29, 2004.

- (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

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\$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 \$.43 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%.

On November 29, 2004, the Board of Directors of Lancer approved a new employment agreement and the promotion of Mr. Castner to President. The agreement is for a term of two years. Mr. Castner's salary shall be \$155,000 for the first year with a possible merit increase after the first year. Mr. Castner shall also receive a stock option for 100,000 shares at fair market value at the time of grant to be granted no later than May 31, 2005. These options were granted in February at an exercise price of \$.70 per share. The agreement was filed as an exhibit to a Form 8-K filed by Lancer November 30, 2004.

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- (18) On November 19, 2004 the Board of Directors at Lancer resolved that effective January 1, 2005, the compensation for Lancer's Chairman shall be reduced to \$30,000 per year. The Directors also resolved that effective December 1, 2004, Lancer's Chief Executive Officer's compensation is to be reduced from 31,250 shares of common stock per quarter to 20,000 shares per quarter.

On January 20, 2005 the Board of Directors at Lancer resolved that the compensation for Lancer's Chairman will be reduced to stock only of 12,000 shares of common stock per quarter.

- (19) 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; and service fees of approximately \$2,900 per month and a lease of \$2,000 per month.
- (20) 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 February 28, 2005. 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

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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 certain expenses. 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 February 28, 2005."

- (21) The Chief Executive Officer and Chief Financial Officer of Biomerica are currently deferring part of their cash wages. Their wages are being recorded as an administrative expense, with deferred amounts being recorded as part of accrued compensation on the balance sheet. The balance due them as of February 28, 2005 was \$264,284.

On January 20, 2005 the Board of Directors at Biomerica resolved that an additional \$30,000 of the total compensation for the Company's Chief Executive Officer will be accrued by Biomerica, rather than by the Lancer subsidiary, since he is now spending more of his time at Biomerica.

- (22) Included in accounts payable at February 28, 2005 is \$117,153 due for rental of the Company's facilities according to the terms of the lease. All of this amount is past due and the Company is in default of the lease.
- (23) The lease for the Company's facilities expires October 31, 2005. The Company's management has requested an extension of that lease and is waiting for a response from the landlords regarding that request. There is no assurance that the management will be able to obtain an extended lease.

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- (24) On December 7, 2004 the Company entered into an agreement with an investment banking company to raise financing of between one million and two million dollars in the form of debt on a best effort basis. There can be no assurance that the Company will be successful in raising such funds.

- (25) 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. The preparation of these consolidated 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 more significant judgments and estimates used in the preparation of our consolidated financial statements. Although we believe that our

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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 recognition of revenue, the Allowance for Doubtful Accounts, Inventory Reserves for Obsolescence and Declines in Market Value, Impairment of Long-Lived Assets, Stock Based Compensation and Deferred Income Tax Valuation and Allowances.

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, of 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 February 28, 2005, 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.

In the future, if sufficient evidence of our ability to generate sufficient future taxable income in certain tax jurisdictions becomes apparent, we may be required to reduce our valuation allowances, resulting in income tax benefits in our consolidated statement of operations. We evaluate the realizability of the deferred tax assets and assess the need for valuation allowance quarterly. The utilization of the net operating loss carryforwards could be substantially limited due to restrictions imposed under federal and state laws upon a change of ownership.

We have adopted SFAS No. 123, "Accounting for Stock-Based Compensation," for Disclosure purposes. Under SFAS No. 123, we measure compensation for

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our stock-based employee compensation plan using the intrinsic value method prescribed in Accounting Principles Board ("APB") No. 25, "Accounting for Stock Issued to Employees" and its related interpretations. We provide pro forma disclosure of the effect on net income or loss as if the fair value based method prescribed in SFAS No. 123 has been applied in measuring compensation expense.

The Company has yet to determine the effect SFAS No. 123R may have in its financial statements, if any. The revised SFAS 123R eliminates the alternative to use Opinion 25's intrinsic value method of accounting, and instead, requires entities to recognize the costs of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards. The revised SFAS 123R also requires that public entities measure liabilities incurred to employees in share-based payment transactions at fair value and estimate the number of instruments for which the requisite service is expected to be rendered. Any incremental compensation cost for a modification of the terms or conditions of an award is to be measured by comparing the fair values before and after the modification.

### (26) Risks and Uncertainties

**License Agreements** - Certain of the Company's sales of products are governed by license agreements with outside third parties. All of such license agreements to which the Company currently is a party, are for fixed terms which will expire after ten years from the commencement of the agreement or upon the expiration of the underlying patents. After the expiration of the agreements or the patents, the Company is free to use the technology that had been licensed. There can be no assurance that the Company will be able to obtain future license agreements as deemed necessary by management. The loss of some of the current licenses or the inability to obtain future licenses could have an adverse affect on the Company's financial position and operations. Historically, the Company has successfully obtained all the licenses it believed necessary to conduct its business.

**Distribution** - The Company has entered into various exclusive and non-exclusive distribution agreements (the "Agreements") which generally specify territories of distribution. The agreements range in term from one to five years. The Company may be dependent upon such distributors for the marketing and selling of its products worldwide during the terms of these agreements. Such distributors are generally not obligated to sell any specified minimum quantities of the Company's product. There can be no assurance of the volume of product sales that may be achieved by such distributors.

**Government Regulations** - The Company's products are subject to regulation by the FDA under the Medical Device Amendments of 1976 (the "Amendments"). The Company has registered with the FDA as required by the Amendments. There can be no assurance that the Company will be able to obtain regulatory clearances for its current or any future products in the United States or in foreign markets.

**European Community** - The Company is required to obtain certification in the European Community to sell products in those countries. The certification requires the Company to maintain certain quality standards. The Company has been granted certification on certain products. However, there is no assurance that the Company will be able to retain its certification in the future.

**Risk of Product Liability** - Testing, manufacturing and marketing of the Company's products entail risk of product liability. The Company



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currently has product liability insurance. There can be no assurance, however, that the Company will be able to maintain such insurance at a reasonable cost or in sufficient amounts to protect the Company against losses due to product liability. An inability could prevent or inhibit the commercialization of the Company's products. In addition, a product liability claim or recall could have a material adverse effect on the business or financial condition of the Company.

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### (27) Subsequent Events

On March 16, 2005 management of Lancer Orthodontics signed a strategic marketing, sales and manufacturing agreement with Lingualcare, Inc. The terms of the agreement provide for Lancer to manufacture Lingualcare's products in Lancer's Mexicali facilities, and for Lancer to assist in introducing, marketing and promoting Lingualcare's orthodontic products. Lancer shall be paid for the manufacturing of the products, and shall further receive shares of Lingualcare's common stock and warrants to purchase additional shares of common stock. The vesting of the Shares and Warrants shall be based on certain milestones to be achieved over a three to four year period. This agreement will require Lancer to invest in new manufacturing equipment and upgrade its facility, and invest into sales and marketing expenditures. Lancer's board anticipates that Lancer will raise the capital necessary for this venture through the sale of restricted common shares of Lancer's stock through a private placement. The private placement is expected to occur in the fiscal fourth quarter of 2005. This private placement will result in the further dilution of Biomerica's ownership in Lancer and could result in Biomerica's controlling ownership (through direct shares owned combined with shares owned by Biomerica's board members) in Lancer to fall below 50%. At this point Lancer's financials would no longer be consolidated with those of Biomerica.

On April 5, 2005, the Board of Directors of Lancer granted stock options for 67,500 shares of Lancer common stock to two employees and three directors. The exercise price of the options are \$.75 per share. The options vest over four years and are exercisable one quarter immediately, and one quarter per year thereafter.

On April 5, 2005, the Board of Directors of Lancer voted to add Lea Nesbit, Chief Executive Officer of Lingualcare, as a member of the board of directors, effective immediately.

### 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

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RESULTS. THESE RISKS AND UNCERTAINTIES ALSO INCLUDE THE SUCCESS OF THE COMPANY IN RAISING NEEDED CAPITAL, 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 \$6,691,509 for the nine months ended February 29, 2004 as compared to \$6,899,088 for the same period in the prior fiscal year. This represents a decrease of \$207,579 or 3.0% for the nine-month period. Of this decrease \$160,329 was attributable to a decrease in sales at Lancer. Consolidated net sales for the quarter then ended were \$2,344,536 as compared to \$2,464,873 for the same period in the previous year. This represents a decrease of \$120,337, or 4.9%. Of this quarterly decrease \$167,422 was attributable to sales at Lancer. Biomerica had an increase by \$47,085 due to sales to new distributors. The nine-month decrease in sales at Lancer was primarily attributable to decreased domestic sales. Increases in sales at Biomerica were a result of sales of new products and an increase in foreign sales.

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Cost of sales as a percentage of sales decreased for the nine months from 69.3% to 66.7% and increased from 66.5% to 66.7% for the quarter. Lancer's cost of sales as a percentage of sales decreased from 71.3% to 70.8% for the nine months and for the quarter increased from 70.1% to 71.2%. The Lancer percentage decrease in cost of goods sold for the nine months was attributable to an increase in the domestic sales prices. Lancer had increased cost of goods sold for the quarter due to production and promotion expenses, which was offset by domestic price increases. Biomerica's cost of sales as a percentage of sales decreased for the nine months from 65.6% to 60.0%. For the quarter Biomerica's cost of sales remained constant at 60.2% to 60.2%. For the nine months the decrease was primarily due to higher costs in the prior year during the transfer of manufacturing to Mexico.

Selling, general and administrative costs decreased by \$54,647, or 2.4% for the nine months and increased by \$4,210, or .6% for the quarter. Lancer had increased selling, general and administrative costs of \$96,157 for the nine months and \$32,330 for the quarter due to the expense of stock compensation for officers and labor, brochures and samples in the selling and marketing departments. Biomerica's expenses for the nine months decreased by \$150,804 and for the three months decreased by \$28,120. Biomerica's expenses decreased for the nine months due to lower commissions, wages, rent, accounting and trade show expenses.

Research and development decreased by \$3,307, or 1.6% for the nine months and decreased by \$4,061 for the three months. Lancer had a decrease in research and development costs of \$14,482 and decreased costs of \$5,498 for the nine and three months, respectively due to a decrease in labor costs charged to research and development. Biomerica had increased research and development costs of \$11,175 for the nine months and of \$1,437 for the three months due to higher wages and materials.

For the nine months ended February 28, 2005, other income (expense) of \$19,501 was realized as compared to \$54,514 in the prior year. In the prior year Lancer

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had higher other income due to bad debt recovery.. In this fiscal year Biomerica realized proceeds from the sale of marketable securities. For the three months, other income (expense) was (\$3,472) as compared to \$21,256. The decrease was primarily due to the sale of securities by Biomerica in the prior fiscal year.

Interest expense increased by \$4,572 (19.0%) for the nine months compared to the previous year and increased by \$2,369 (27.1%) for the quarter. The increase was primarily due to higher borrowings on the line of credit at Lancer.

### LIQUIDITY AND CAPITAL RESOURCES

As of February 28, 2005, the Company had cash and available-for-sale securities in the amount of \$234,262 and working capital of \$2,511,817. Cash and working capital totaling \$203,408 and \$2,631,992, 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 couple of 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, Inc. 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 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 new or additional debt financing. The Company is currently in negotiations to obtain a line of credit for product acquisition financing, however, this line of credit would not be available for general operations. Although the Company's management recognizes the imminent need to secure additional financing 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 the Company.

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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 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 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 \$104 interest payable under this note payable at February 28, 2005. On November 19, 2004, the Company entered into an agreement entitled "Amendment of the Note, Loan and Modification Agreement". This amends the "Loan Modification, Forbearance and Security Agreement" and "Amended and Restated Promissory Note" which were included as exhibits to the Form 10QSB filed April 14, 2004. The Amendment of the Note, Loan and Modification Agreement was filed as an exhibit to a Form 8K filed November 24, 2004. The agreement extends the maturity date of the note until August 31, 2005 and allows for minimum payments of \$4,000 per month and additional contingent payments of up to \$3,500 per month based on the Company's quarterly performance. Collateral remains the same under the Amendment.

During the nine months ended February 28, 2005 and February 29, 2004, the Company's net cash and cash equivalents decreased by \$131,328 and \$346,244, respectively. Cash provided by financing activities was \$205,473, which resulted from borrowings on the Lancer line of credit of \$195,415, proceeds from an exercise of stock options at Lancer, and proceeds of \$8,888 from the sale of marketable securities at Biomerica.

At February 28, 2005, Lancer has a \$400,000 line of credit with Community National Bank (formerly Cuyamaca Bank). Borrowings are made at prime plus 2.0% (7.50% at February 28, 2005), and are limited to 80% of domestic accounts receivable less than 90 days old. The outstanding balance at February 28, 2005 was \$195,415 and the unused portion available was approximately \$144,585. Lancer requested that Community National Bank reserve \$60,000 of its available Credit line 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 tangible net worth ratio of \$2,700,000 and a zero balance be maintained for 30 consecutive days during the term. Lancer is not required to maintain compensating balances in connection with this lending agreement. Proceeds from this line cannot be used to support the operations of Biomerica. Lancer was in compliance with its debt covenants at February 28, 2005.

The Lancer line of credit expired January 8, 2005 and was renewed until October 15, 2005.

During the nine months ended February 28, 2005, the Company's operating activities used cash of \$135,688 and \$147,171 for the periods ended February 28,

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2005 and February 29, 2004. Included in this was depreciation and amortization of \$120,747, and \$95,075. Depreciation and amortization increased over the prior year due to the recent purchases of equipment, in particular at Lancer where they are purchasing equipment for manufacture of new products. The minority interest in the losses at Lancer was \$127,270 as compared to \$48,069 in the prior year. Lancer had increased losses this fiscal year. Common stock, warrants and options issued for services rendered decreased from \$55,172 to \$10,400 due to less compensation being paid in the form of equity at Biomerica. Common stock, warrants and options issued for services rendered at Lancer was \$58,250 for the first nine months of fiscal 2005. Provisions for losses on accounts receivable decreased for the nine months ended February 28, 2005, due to the write-off of certain bad debts at Biomerica. Gross accounts receivable have increased by \$181,100 for the first nine months of fiscal 2005. Of this, \$94,965 was attributable to the timing of accounts receivable collections at Lancer. The balance of \$86,135 is attributable to increased sales, and therefore higher receivables, at Biomerica. Inventories increased for the nine months ended February 28, 2005 by \$162,643. Of this, \$104,336 was due to increases at Lancer due to lower sales. Prepaid expenses decreased for the nine months ended February 28, 2005 by \$58,622. Lancer had decreased prepaids of \$59,271 and Biomerica had increased prepaids of \$649. The movement in prepaid expenses was primarily due to prepaid inventory orders at both Lancer in the prior year. Accounts payable increased by \$126,772 for first nine months of fiscal 2005. Of this \$35,680 was attributable to Lancer and \$91,092 to Biomerica. Lancer's accounts payable increased due to inventory shipments that were received at the end of the quarter ended February 28, 2005 and Biomerica's increased due to the purchase of inventory due to higher sales. Accrued compensation increased by \$82,709 for the nine months ended February 28, 2005 due to the accrual of wages at Biomerica for the CEO and CFO.

Cash provided by financing activities was \$263,723, which resulted from borrowings on the Lancer line of credit of \$195,415, the sale of marketable securities of \$8,888 at Biomerica, shares issued by Lancer for wages of \$58,250 (Lancer is paying its part-time CEO and Chairman in the form of restricted common stock) and the exercise of stock options at Lancer of \$1,170.

Lancer has been investing in equipment to manufacture new products. Of the \$177,950 of purchases of property and equipment for the period ended February 28, 2005, \$149,263 relates to Lancer. Lancer has used the new equipment to build inventory in anticipation of higher sales. The inventory at Lancer has increased by \$104,336 for the nine months ended February 28, 2005. Lancer has had to draw on its line of credit due to these expenses.

The Chief Executive Officer and Chief Financial Officer of Biomerica are currently deferring part of their salaries. Their salaries are being recorded as an administrative expense. All deferred salaries are being recorded as part of the accrued compensation on the balance sheet.

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.

### 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,

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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, 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

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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 February 28, 2005, 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 February 28, 2005, 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.

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- 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.
- Item 6. EXHIBITS AND REPORTS ON FORM 8-K. Inapplicable.

Exhibits

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- 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.

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: April 14, 2005

BIOMERICA, INC.

By: /S/ Zackary S. Irani

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Zackary S. Irani  
Chief Executive Officer