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BIOMERICA INC
Form 10QSB
April 14, 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 February 29, 2004

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 April 14, 2004.

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BIOMERICA, INC.

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PART I - FINANCIAL INFORMATION

SUMMARIZED FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

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| | Nine Months Ended February 29, | |
|--|-----------------------------------|--------------|
| | 2004 | 2003 |
| | ----- | ----- |
| Net sales | \$ 6,899,088 | \$ 6,517,414 |
| Cost of sales | 4,784,264 | 4,515,017 |
| Gross profit | \$ 2,114,824 | \$ 2,002,397 |
| Operating Expenses: | | |
| Selling, general and administrative | 2,250,086 | 2,113,020 |
| Research and development | 207,123 | 185,459 |
| | ----- | ----- |
| | 2,457,209 | 2,298,479 |
| | ----- | ----- |
| Operating loss from continuing operations | (342,385) | (296,082) |
| | ----- | ----- |
| Other Expense (income): | | |
| Interest expense | 24,120 | 25,273 |
| Other (income) expense, net | (54,514) | (51,108) |
| | ----- | ----- |
| | (30,394) | (25,835) |
| | ----- | ----- |
| Loss from continuing operations, before minority interest in net (loss) gain of consolidated subsidiary and income taxes | (311,991) | (270,247) |
| Minority interest in net (loss) gain of consolidated subsidiary | (48,069) | 31,209 |
| | ----- | ----- |
| (Loss) gain from continuing operations, before income taxes . | (263,922) | (301,456) |
| Income tax expense | 26 | 3,018 |
| | ----- | ----- |
| Net (loss) gain from continuing operations | (263,948) | (304,474) |

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

Nine Months Ended
February 29,

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| | 2004 | 2003 |
|---|--------------|--------------|
| | ----- | ----- |
| Discontinued operations: | | |
| (Loss) income from discontinued operations, net | (4,359) | (40,022) |
| | ----- | ----- |
| Net (loss) gain | (268,307) | (344,496) |
| Other comprehensive gain (loss), net of tax | | |
| Unrealized gain (loss) on available-for-sale securities | 35,580 | (2,122) |
| | ----- | ----- |
| Comprehensive (loss) gain | \$ (232,727) | \$ (346,618) |
| | ===== | ===== |
| Basic net (loss) gain per common share: | | |
| Net (loss) gain from continuing operations | \$ (.05) | \$ (.06) |
| Net (loss) from discontinued operations | (.00) | (.01) |
| | ----- | ----- |
| Basic net (loss) gain per common share | \$ (.05) | \$ (.07) |
| | ===== | ===== |
| Diluted net (loss) gain per common share | | |
| Net (loss) gain from continuing operations | \$ (.05) | \$ (.06) |
| Net loss from discontinued operations | (.00) | (.01) |
| | ----- | ----- |
| Diluted net loss per common share | \$ (.05) | \$ (.07) |
| | ===== | ===== |
| Weighted average number of common and common equivalent shares: | | |
| Basic and diluted | 5,726,993 | 5,224,867 |
| | ===== | ===== |

The accompanying notes are an integral part of these statements.

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BIOMERICA, INC.

CONDENSED CONSOLIDATED BALANCE SHEET (UNAUDITED)

| | February 29, 2004 |
|--|----------------------|
| | ----- |
| Assets | |
| Current Assets (Notes 2 & 14) | |
| Cash and cash equivalents | \$ 178,923 |
| Available for-sale securities | 33,577 |
| Accounts receivable, less allowance for doubtful accounts of \$165,708 . | 1,746,278 |
| Inventories, net of reserve of \$227,079 | 2,637,195 |
| Notes receivable | 4,119 |

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| | |
|---|-------------|
| Prepaid expenses and other | 152,210 |
| | ----- |
| Total Current Assets | 4,752,302 |
| Inventory, non-current | 25,000 |
| Property and Equipment, net of accumulated depreciation and amortization .. | 659,340 |
| Intangible assets, net of accumulated amortization | 41,360 |
| Other Assets | 62,904 |
| | ----- |
| | \$5,540,906 |
| | ----- |

The accompanying notes are an integral part of these statements.

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BIOMERICA, INC.

CONDENSED CONSOLIDATED BALANCE SHEET - Continued (UNAUDITED)

| | |
|--|----------------------|
| | February 29, 2004 |
| | ----- |
| Liabilities and Shareholders' Equity | |
| Current Liabilities | |
| Current portion of term loan | \$ 25,004 |
| Accounts payable and accrued liabilities | 1,205,018 |
| Accrued compensation | 472,711 |
| Shareholder loan | 312,216 |
| Net liabilities from discontinued operations | 368,504 |
| | ----- |
| Total Current Liabilities | 2,383,453 |
| Long term portion of term loan | 72,927 |
| Long term portion of shareholder debt | 4,000 |
| | ----- |
| Total Liabilities | 2,460,380 |
| | ----- |
| Minority interest | 2,105,742 |
| | ----- |
| 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 | 17,211,165 |

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| | |
|--|--------------|
| Accumulated other comprehensive gain | 25,923 |
| Accumulated deficit | (16,722,497) |
| | ----- |
| Total Shareholders' Equity | 974,784 |
| | ----- |
| Total Liabilities and Equity | \$ 5,540,906 |
| | ===== |

The accompanying notes are an integral part of these statements.

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

| For the nine months ended February 29, | 2004 | 2003 |
|--|--------------|-----------|
| | ----- | ----- |
| Cash flows from operating activities: | | |
| Net loss from continuing operations | \$ (263,948) | \$ (304,4 |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 95,075 | 106,1 |
| Realized gain on sale of available-for-sale security | 15,115 | |
| Minority interest in net (loss) gain of consolidated Subsidiary | (48,069) | 31,2 |
| Common stock, warrants and options issued for services rendered | 55,172 | 67,5 |
| Provision for losses on accounts receivable | 45,663 | (1,9 |
| Warrant and options issued for services rendered | -- | 48,5 |
| Changes in current assets and liabilities: | | |
| Accounts Receivable | (128,705) | (32,1 |
| Inventories | 12,737 | 414,2 |
| Prepaid expenses and other current assets | 15,094 | 41,9 |
| Accounts payable and other accrued liabilities | (75,116) | 49,8 |
| Accrued compensation | 129,811 | 17,2 |
| | ----- | ----- |
| Net cash (used in) provided by operating activities | (147,171) | 438,0 |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (339,016) | (90,3 |
| Other assets | (19,504) | (3,6 |
| Purchases of intangibles | -- | (21,9 |
| | ----- | ----- |
| Net cash used in investing activities | (358,520) | (115,9 |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Issuance of shares by subsidiary | 7,750 | 17,9 |
| Increase (decrease) in shareholder loan | 2,666 | |
| Private placement, net of offering costs | 50,500 | (46,7 |
| Proceeds from sale of common stock subscribed | -- | 25,0 |
| Exercise of stock options | 2,000 | |
| Decrease in line of credit | (426) | (65,1 |
| Increase in term loan | 97,931 | |

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| | | |
|--|------------|----------|
| Net cash provided by (used in) financing activities | 160,421 | (68,9 |
| Net cash used in discontinued operations | (974) | (2,2 |
| Net (decrease) increase in cash and cash equivalents | (346,244) | 250,8 |
| Cash at beginning of period | 525,167 | 329,2 |
| Cash at end of period | \$ 178,923 | \$ 580,1 |
| 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 | |

The accompanying notes are an integral part of these statements.

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BIOMERICA, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (UN
FOR THE NINE MONTHS ENDED February 29, 2004

| | Common Stock | | | Common Stock Subscribed | | Accumul Other Compreh Gain (L |
|---|------------------------|------------|----------------------------------|----------------------------|----------|--|
| | Number of Shares | Amount | Additional Paid-in Capital | Shares | Amount | |
| Balance at May 31, 2003 | 5,522,431 | \$ 441,793 | \$ 17,117,393 | 18,000 | \$ 4,500 | \$ (|
| Exercise of stock Options | 10,000 | 800 | 1,200 | | | |
| Change in unrealized gain on available for sale securities | | | | | | 3 |
| Net proceeds from private placement | 220,000 | 17,600 | 37,400 | (18,000) | (4,500) | |
| Compensation expense related to the fair value of common stock | | | | | | |

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and warrants
 issued to employees
 in excess of
 consideration received 55,172

Net loss

| | | | | | | | | | |
|-------------------|-----------|----|---------|----|------------|-------|----|-------|-------|
| Balance at | 5,752,431 | \$ | 460,193 | \$ | 17,211,165 | -- | \$ | -- | \$ |
| February 29, 2004 | ===== | | ===== | | ===== | ===== | | ===== | ===== |

The accompanying notes are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

February 29, 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, 2003, 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 report amounts of revenues and expenses during the reporting 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.

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, 2003 for more detailed footnotes.

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.

- (2) As of February 29, 2004, the Company had cash and available-for-sale securities in the amount of \$212,500 and working capital of \$2,368,849.

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Cash and working capital totaling \$170,471 and \$2,555,175, 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 adequately or should the Company be unable to secure additional financing, the result for the Company could be the inability to continue operations. The Company will continue to have limited cash resources. 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 us.

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, 2003, 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 operating.

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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's shareholder's line of credit expired September 13, 2003. The unpaid principal and interest of \$337,835 was converted into a note payable bearing interest at 8% and payable in monthly installments over four years. The Company was making payments of \$7,300 per month towards principal and interest. As of February 29, 2004 the terms of the loan were still being negotiated. On March 22, 2004 a Loan Modification, Forbearance and Security Agreement and an Amended and Restated Promissory Note were finalized. The balance of interest and principal as of March 22, 2004 was \$313,318. The terms of the agreements are that Janet Moore has agreed to a forbearance of any payments for the length of the agreement, which expires September 1, 2004. Collateral for the loan is all the assets of the Company except the Lancer common stock currently owned by Biomerica. A warrant for 40,000

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shares of restricted common stock exercisable at a price of \$.51 per share has been awarded as compensation for the forbearance. In addition, Janet Moore has agreed to defer accrued wages now owed to her and continue deferring wages earned during this forbearance period.

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 nine and three months ended February 29, 2004 and February 28, 2003 as follows:

| | Nine Months Ended | | Three Months Ended | |
|--|-------------------|--------------|--------------------|-------------|
| | 2/29/04 | 2/28/03 | 2/29/04 | 2/28/03 |
| Net (loss) gain from continuing operations, as reported | \$ (263,948) | \$ (304,474) | \$ 64,591 | \$ (24,644) |
| Plus: Stock-based employee compensation expense included in reported net gain (loss) | 55,172 | 67,517 | 9,684 | 16,182 |
| Less: Stock-based employee compensation expense determined using fair value based method | (18,918) | (36,308) | (6,269) | (12,270) |
| Net (loss) gain from continuing operations, pro forma | \$ (227,694) | \$ (273,265) | \$ 68,006 | \$ (20,732) |
| Pro forma net (loss) gain from continuing operations per share - basic | \$ (0.04) | \$ (0.06) | \$.01 | \$ (.00) |
| Pro forma net (loss) gain from continuing operations per share - diluted | \$ (0.04) | \$ (0.06) | \$.01 | \$ (.00) |

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- (3) The following summary presents the options granted, exercised, expired, and outstanding as of February 29, 2004:

| | Number of Options | | Total | Weighted Average Exercise Price |
|-----------------------------|-------------------|--------------|-----------|--|
| | Employee | Non-employee | ----- | ----- |
| Outstanding May 31, 2003 | 990,386 | 75,000 | 1,065,386 | \$0.99 |
| Granted | -- | -- | -- | 0.00 |
| Exercised | -- | (10,000) | (10,000) | 0.20 |
| Expired | (2,250) | -- | (2,250) | 0.85 |

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| | | | | |
|----------------------------------|-----------|-----------|-----------|--|
| Cancelled | (3,000) | -- | (3,000) | 0.40 |
| Outstanding February 29, 2004 | 985,136 | 65,000 | 1,050,136 | \$1.00 |
| | ----- | ----- | ----- | ----- |
| | ===== | ===== | ===== | ===== |
| | | | | Weighted Average Exercise Price |
| | | | | ----- |
| Outstanding May 31, 2003 | 1,285,688 | 1,131,746 | 2,417,434 | \$2.79 |
| Granted | 170,000 | 32,000 | 202,000 | 0.25 |
| Exercised | -- | -- | -- | 0.00 |
| Expired | -- | -- | -- | 0.00 |
| Outstanding February 29, 2004 | 1,455,688 | 1,163,746 | 2,619,434 | \$2.60 |
| | ----- | ----- | ----- | ----- |
| | ===== | ===== | ===== | ===== |

- (4) 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, 2003, for a description of the investments in affiliates and consolidated subsidiaries.
- (5) Reference is made to Notes 5 & 11 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, 2003, for information on commitments and contingencies.
- (6) Aggregate market value exceeded cost of available-for-sale securities by approximately \$25,923 at February 29, 2004.

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(7) 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. 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 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.

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As of February 29, 2004, there was a total of 3,669,570 potential dilutive shares of common stock outstanding.

- (8) In June 2001, the FASB issued SFAS No. 143, "ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS", which requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred with the associated asset retirement costs being capitalized as a part of the carrying amount of the long-lived asset. SFAS No. 143 also includes disclosure requirements that provide a description of asset retirement obligations and reconciliation of changes in the components of those obligations. The statement is effective for fiscal years beginning after June 15, 2002. The adoption of SFAS No. 143 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," which updates accounting and reporting standards for personnel and operational restructurings. The Company was required to adopt SFAS No. 146 for exit, disposal or other restructuring activities that are initiated after December 31, 2002, with early application encouraged. The Company adoption of SFAS No. 146 did not have a material effect on the Company's consolidated 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.

In November 2002, FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee.

The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are applicable

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for financial statements of interim periods ending after December 15, 2002. The adoption of FIN 45 did not have a material impact on the Company's financial position, results of operations or cash flows.

In January 2003, FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). This interpretation clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," relating to consolidation of certain entities. FIN 46 will require 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 operation on a stand-alone basis, or whose equity holders lack certain characteristics of a controlling financial interest. For entities indentified as VIEs, FIN 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 46 also sets forth certain disclosures regarding interests in VIEs that are deemed significant, even if consolidation is not required. The adoption of FIN 46 did not have a material impact on the Company's financial position, results of operations or cash flows.

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

| | For the Nine Months Ended | |
|--|---------------------------|-------------|
| | 2/29/04 | 2/28/03 |
| | ----- | ----- |
| Revenues from sales to unaffiliated customers: | | |
| United States | \$3,229,000 | \$3,453,000 |
| Asia | 157,000 | 166,000 |
| Europe | 2,063,000 | 1,614,000 |
| South America | 330,000 | 283,000 |
| Oceania | 377,000 | 325,000 |
| Other | 743,000 | 676,000 |
| | ----- | ----- |
| | \$6,899,000 | \$6,517,000 |
| | ===== | ===== |

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

- (10) 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.
- (11) At February 29, 2004, Lancer has a \$400,000 line of credit with Cuyamaca Bank, which expires January 8, 2005. Borrowings are made at prime plus 2.0% (6% at February 29, 2004, and are limited to 80% of accounts receivable less than 90 days old. The outstanding balance at February 29, 2004 was \$0 and the unused portion available was approximately \$400,000. Lancer was in compliance with its debt covenants at February 29, 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 tangible net worth ratio of \$2,700,000 and a zero

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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.

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Lancer also has a term loan for \$100,000 with Cuyamaca Bank that matures January 8, 2008. This loan requires 48 monthly payments of approximately \$2,300 (principal and interest) at an interest rate of prime plus 2% (6% at February 29, 2004). The outstanding balance at February 29, 2004 was approximately \$98,000, with approximately \$25,000 classified as a current liability. The term loan is for the purchase of new equipment but is collateralized by substantially all of the assets of the corporation.

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. The outstanding principal and interest on September 12, 2003 was \$337,835, including principal of \$288,050 and interest of \$48,985, all of which was converted into a note payable bearing interest at 8% with interest and principal due monthly. The Company was paying \$7,300 per month toward interest and principal. As of February 29, 2004 the terms of the loan were still being negotiated. On March 22, 2004 a Loan Modification, Forbearance and Security Agreement and an Amended and Restated Promissory Note were finalized. The balance of interest and principal as of March 22, 2004 was \$313,318. The terms of the agreements are that Janet Moore has agreed to a forbearance of any payments for the length of the agreement, which expires September 1, 2004. Collateral for the loan is all the assets of the Company except the Lancer common stock currently owned by Biomerica. A warrant for 40,000 shares of restricted common stock exercisable at a price of \$.51 per share have been awarded as compensation for the forbearance. In addition, Janet Moore has agreed to defer accrued wages now owed to her and continue deferring wages earned during this forbearance period.

- (12) In June 2003, the Company issued 202,000 shares of restricted common stock in a private placement to insiders and qualified investors. The stock was sold at \$.25 per share and had one warrant for the purchase of restricted common stock attached to each share of common stock purchased. 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.

On June 2, 2003, Lancer granted 52,500 stock options to purchase shares of Lancer common stock at an exercise price of \$.43 per share to directors of Lancer for services rendered. The options vest over two years and have a term of five years.

On June 2, 2003, Lancer granted 75,000 stock options to purchase shares of Lancer common stock at an exercise price of \$.43 per share to its Chief Executive Officer in lieu of salary. The options vest over three years and have a term of five years.

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On June 2, 2003, Lancer granted 120,000 stock options to purchase shares of the Lancer's common stock at an exercise price of \$.43 per share as pursuant to terms of the Employment agreement between Lancer and Dan Castner, the Vice President of Sales and Marketing. The options vest over four years and have a term of five years.

(13) Subsequent Events

On March 23, 2004, in order to strengthen its balance sheet the board of directors of Lancer approved a private placement with the intent of raising between \$150,000 and \$350,000. The price of the restricted shares was \$.60 per share with one warrant exercisable at \$.85 per share for each share purchased. A total of 450,000 shares of restricted common stock were subscribed to, raising a total of \$270,000.

On April 12, 2004, an agreement was signed between Lancer Orthodontics ("Lancer") and Allen Barbieri ("Barbieri") wherein Barbieri will serve as the part-time interim Chief Executive Officer of Lancer for a period of two years or less. He shall receive as compensation 62,500 shares of Lancer restricted common stock for every six months of employment with Lancer. At the beginning of each quarter 31,250 shares shall vest. Barbieri shall not be entitled to any other form of cash or equity compensation, unless determined otherwise in the future.

On March 31, 2004, a warrant for 40,000 shares of restricted common stock was issued to The Janet Moore Trust for the forbearance of payments on the note payable to the Company in the amount of \$313,318. The warrants are at the exercise price of \$.51, have an expiration of five years, and are fully vested at the date of grant. The Company recorded a noncash expense of \$20,800 representing the full value of the warrants in March of 2004.

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(14) Reportable business segments for the nine months and quarter ended February 29 30, 2004 and 2003 are as follows:

| | Nine Months Ended February 29, | | Three Months Ended February 29, | |
|-----------------------------|-----------------------------------|-------------|------------------------------------|------------|
| | 2004 | 2003 | 2004 | 2003 |
| ----- | | | | |
| Domestic sales: | | | | |
| Orthodontic products | \$2,351,000 | \$2,323,000 | \$ 833,000 | \$ 756,000 |
| ===== | | | | |
| Medical diagnostic products | \$ 878,000 | \$1,130,000 | \$ 228,000 | \$ 335,000 |
| ===== | | | | |
| Foreign sales: | | | | |
| Orthodontic products | \$2,172,000 | \$1,975,000 | \$ 806,000 | \$ 752,000 |
| ===== | | | | |
| Medical diagnostic products | \$1,498,000 | \$1,089,000 | \$598,000 | \$ 448,000 |

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| | Nine Months Ended February 29, 2004 | | Three Months Ended February 29, 2004 | |
|---|---|--------------|--|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| ----- | | | | |
| Net sales: | | | | |
| Orthodontic products | \$4,523,000 | \$4,298,000 | \$1,639,000 | \$1,508,000 |
| Medical diagnostic products | 2,376,000 | 2,219,000 | 826,000 | 783,000 |
| ----- | | | | |
| Total | \$6,899,000 | \$6,517,000 | \$2,465,000 | \$2,291,000 |
| ===== | | | | |
| Operating (loss) income: | | | | |
| Orthodontic products | \$ (92,000) | \$ (1,000) | \$ 56,000 | \$ 22,000 |
| Medical diagnostic products | (250,000) | (297,000) | 42,000 | (24,000) |
| ----- | | | | |
| Total | \$ (342,000) | \$ (296,000) | \$ (98,000) | \$ (2,000) |
| ===== | | | | |
| Operating loss from discontinued segment: | | | | |
| ReadyScript | \$ 4,359 | \$ 40,022 | \$ 1,415 | \$ 1,491 |
| ----- | | | | |
| Total | \$ 4,359 | \$ 40,022 | \$ 1,415 | \$ 1,491 |
| ===== | | | | |
| Depreciation and amortization expense: | | | | |
| Orthodontic products | \$ 48,000 | \$ 64,000 | 22,000 | 16,000 |
| Medical diagnostic products | 44,000 | 42,000 | 11,000 | 18,000 |
| ----- | | | | |
| Total | \$ 92,000 | \$ 106,000 | 33,000 | 34,000 |
| ===== | | | | |
| Domestic long-lived assets: | | | | |
| Orthodontic products | \$ 387,000 | \$ 92,000 | | |
| Medical diagnostic products | 134,000 | 156,000 | | |
| ----- | | | | |
| Total | \$ 521,000 | \$ 248,000 | | |
| ===== | | | | |
| Foreign long-lived assets: | | | | |
| Orthodontic products | \$ 121,000 | \$ 16,000 | | |
| Medical diagnostic products | 17,000 | 3,600 | | |
| ----- | | | | |
| Total | \$ 659,000 | \$ 267,000 | | |
| ===== | | | | |
| Total assets: | | | | |

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| | | |
|-----------------------------|--------------|-------------|
| Orthodontic products | \$ 3,837,000 | \$3,568,000 |
| Medical diagnostic products | 1,704,000 | 1,545,000 |
| | | |
| Total | \$ 5,541,000 | \$5,113,000 |
| | | |
| Capital expenditures: | | |
| Orthodontic products | \$ 297,000 | \$ 75,000 |
| Medical diagnostic products | 18,000 | 15,000 |
| | | |
| Total | \$ 315,000 | \$ 90,000 |
| | | |

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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 29, 2004 and February 28, 2003.

- (15) 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 \$.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%.
- (16) 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.
- (17) 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 29, 2004. The Company enters into indemnification provisions under (i) its

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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 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 29, 2004."

- (18) The Chief Executive Officer and Chief Financial Officer of Biomerica are currently deferring their cash wages. Their wages are being recorded as an administrative expense and reported as part of accrued wages on the balance sheet.
- (19) Included in accounts payable at February 29, 2004 is \$126,768 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.

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(20) 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.

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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 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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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 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.

CRITICAL ACCOUNTING POLICIES

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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 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 29, 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.

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

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We have provided a full valuation reserve related to our substantial deferred tax assets. 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 realizeability 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.

RESULTS OF OPERATIONS

Consolidated net sales for Biomerica were \$6,899,088 for the nine months ended February 29, 2004 as compared to \$6,517,414 for the same period in the prior fiscal year. This represents an increase of \$381,674 or 6% for the nine-month period. Of this increase \$224,692 was attributable to an increase in sales at Lancer. Consolidated net sales for the quarter then ended were \$2,464,873 as compared to \$2,291,377 for the same period in the previous year. This represents an increase of \$173,496, or 8%. Of this quarterly increase \$131,336 was attributable to sales at Lancer. The nine-month increase in sales at Lancer was primarily attributable to increases in sales in Europe and South America and the three-month increase was due to increases in Europe. Increases in sales at Biomerica were a result of sales of new products and an increase in foreign sales.

Cost of sales as a percentage of sales remained constant for the nine months at 69.3% and decreased from 68.2% to 66.5% for the quarter. Lancer's cost of sales as a percentage of sales increased from 71.2% to 71.3% for the nine months and for the quarter decreased from 71.9% to 70.1%. The Lancer percentage decrease in cost of goods sold was attributable to an increase in selling prices for the three months then ended. Biomerica's cost of sales as a percentage of sales increased for the nine months from 65.5% to 65.6%. For the quarter Biomerica's cost of sales increased from 60.2% to 61.1%. For the three months the increase was primarily due to higher material costs due to product mix and expenses in the Mexico facility.

Selling, general and administrative costs increased by \$137,066, or 6% for the nine months and by \$60, or 0% for the quarter. Lancer had increased selling, general and administrative costs of \$132,824 for the nine months and \$39,657 for the quarter. Lancer had decreased labor and professional fees in the administrative area and had increased sales and marketing due to increased labor and advertising costs offset by a decrease in trade show costs.

Research and development increased by \$21,664, or 11.7% for the nine months and decreased by \$9,883 for the three months. Lancer had an increase in research and development costs of \$21,214 and decreased costs of \$7,465 for the nine and three months, respectively. This increase for the nine months expenses was attributable to the development of a new product line. Biomerica had costs consistent with the prior year for the nine-month period and decreased costs of \$2,418 for the three months due to lower wages.

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For the nine months ended February 29, 2004, other income of \$54,514 was realized as compared to \$51,108 in the prior year. In the prior year Lancer had proceeds from an insurance claim. In this fiscal year Biomerica realized proceeds from the sale of marketable securities. For the three months, other income was \$21,256 as compared to \$814. The increase was primarily due to the sale of securities by Biomerica.

Interest expense decreased by \$1,153 (5%) for the nine months compared to the previous year and increased by \$1,171 for the quarter. The decrease was primarily due to the lower loan balance at Biomerica, whereas the quarterly increase was due to an increase of borrowing at Lancer.

The following is a breakdown of the three and six month income statement by company for continuing operations:

3 MONTHS ENDED FEBRUARY 29, 2004

| | Biomerica | Lancer | Total |
|------------------------------------|------------|-------------|-------------|
| Sales | \$ 825,911 | \$1,638,962 | \$2,464,873 |
| Cost of goods | (497,371) | (1,149,066) | (1,646,437) |
| Gross profit | 328,540 | 489,896 | 818,436 |
| Selling, general & administrative | 248,497 | 406,714 | 655,211 |
| Research & development | 37,993 | 27,377 | 65,370 |
| Total operating expenses | 286,490 | 434,091 | 720,581 |
| Operating profit | 42,050 | 55,805 | 97,855 |
| Other (income) expenses | | | |
| Interest | 8,119 | 625 | 8,744 |
| Misc income | (9,990) | (11,266) | (21,256) |
| Total other (income) expenses | (1,871) | (10,641) | (12,512) |
| Gain before interest in subsidiary | 43,921 | 66,446 | 110,367 |

9 MONTHS ENDED FEBRUARY 29, 2004

| | | | |
|-----------------------------------|-------------|-------------|-------------|
| Sales | \$2,376,367 | \$4,522,721 | \$6,899,088 |
| Cost of goods | (1,558,581) | (3,225,683) | (4,784,264) |
| Gross profit | 817,786 | 1,297,038 | 2,114,824 |
| Selling, general & administrative | 948,787 | 1,301,299 | 2,250,086 |
| Research & development | 119,885 | 87,238 | 207,123 |
| Total operating expenses | 1,068,672 | 1,388,537 | 2,457,209 |
| Operating loss | (250,886) | (91,499) | (342,385) |
| Other (income) expenses | | | |
| Interest | 23,234 | 886 | 24,120 |
| Misc income | (31,890) | (22,624) | (54,514) |
| | (8,656) | (21,738) | (30,394) |

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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, 2003, for a more in-depth discussion of subsidiaries.

LIQUIDITY AND CAPITAL RESOURCES

As of February 29, 2004, the Company had cash and available-for-sale securities in the amount of \$212,500 and working capital of \$2,368,849. Cash and working capital totaling \$170,471 and \$2,555,175, 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.

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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 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 adequately or should the Company be unable to secure additional financing, the result for the Company could be the inability to continue operations.

The Company will continue to have limited cash resources. 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 us.

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, 2003 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

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losses and negative cash flows from operations. Biomerica's shareholder's line of credit expired September 13, 2003. The unpaid principal and interest of \$337,835 was converted into a note payable bearing interest at 8% and payable in monthly installments over four years. The Company was making payments of \$7,300 per month towards principal and interest. As of February 29, 2004 the terms of the loan were still being negotiated. On March 22, 2004 a Loan Modification, Forbearance and Security Agreement and an Amended and Restated Promissory Note were finalized. The balance of interest and principal as of March 22, 2004 was \$313,318. The terms of the agreements are that the lender has agreed to a forbearance of any payments for the length of the agreement, which expires September 1, 2004. Collateral for the loan is all the assets of the Company except the Lancer common stock currently owned by Biomerica. A warrant for 40,000 shares of restricted common stock exercisable at a price of \$.51 per share have been awarded as compensation for the forbearance. In addition, Janet Moore has agreed to defer accrued wages now owed to her and continue deferring wages earned during this forbearance period.

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During the nine months ended February 29, 2004, the Company operations used cash of \$149,352. This compares to cash provided by operations of \$438,092 in the same period in the prior fiscal year. The Lancer subsidiary used cash in operations of \$117,909 during this fiscal year and provided cash of \$583,384 in the last fiscal year. Cash provided by financing activities was \$162,602, which resulted from a private placement of \$50,500, increase in shareholder loan of \$2,666, change in minority interest of \$9,931 and an increase in the term loan at Lancer of \$97,931 and exercise of stock option of \$2,000.

The Company purchased \$339,016 in fixed assets during the first nine month of this fiscal year. Of this, \$314,447 was a result of expenditures at the Lancer subsidiary.

The Chief Executive Officer and Chief Financial Officer of Biomerica are not currently taking a cash salary. Their wages are being recorded as an administrative expense and reported as part of accrued wages 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.

At February 29, 2004, Lancer has a \$400,000 line of credit with Cuyamaca Bank, which expires January 8, 2005. Borrowings are made at prime plus 2.0% (6% at February 29, 2004, and are limited to 80% of accounts receivable less than 90 days old. The outstanding balance at February 29, 2004 was \$0 and the unused portion available was approximately \$400,000. Lancer was in compliance with its debt covenants at February 29, 2004.

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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 also has a term loan for \$100,000 with Cuyamaca Bank that matures January 8, 2008. This loan requires 48 monthly payments of approximately \$2,300 (principal and interest) at an interest rate of prime plus 2% (6% at February 29, 2004). The outstanding balance at February 29, 2004 was approximately \$98,000, with approximately \$25,000 classified as a current liability. The term loan is for the purchase of new equipment but is collateralized by substantially all of the assets of the corporation.

On March 23, 2004, in order to strengthen its balance sheet, the board of directors of Lancer approved a private placement with the intent of raising between \$150,000 and \$350,000. The price of the restricted shares was \$.60 per share with one warrant exercisable at \$.85 per share for each share purchased. A total of 450,000 shares of restricted common stock were subscribed to, raising a total of \$270,000.

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. The outstanding principal and interest on September 12, 2003 was \$337,835, including principal of \$288,050 and interest of \$48,985, all of which was converted into a note payable bearing interest at 8% with interest and principal due monthly. The Company was paying \$7,300 per month toward interest and principal. As of February 29, 2004 the terms of the loan were still being negotiated. On March 22, 2004 a Loan Modification, Forbearance and Security Agreement and an Amended and Restated Promissory Note were finalized. The balance of interest and principal as of March 19, 2004 was \$313,318. The terms of the agreements are that Janet Moore has agreed to a forbearance of any payments for the length of the agreement, which expires September 1, 2004. Collateral for the loan is all the assets of the Company except the Lancer common stock currently owned by Biomerica. A warrant for 40,000 shares of restricted common stock exercisable at a price of \$.51 per share have been awarded as compensation for the forbearance. In addition, Janet Moore has agreed to defer accrued wages now owed to her and continue deferring wages earned during this forbearance period.

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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

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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, as were experiences in fiscal year 2002, 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 February 29, 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 February 29, 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.

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Item 1. LEGAL PROCEEDINGS. Inapplicable.

Item 2. CHANGES IN SECURITIES AND USE OF PROCEEDS. The following shares of Restricted common stock were issued during the nine months Ended February 29, 2004:

| Date | Title | Amount | Class or Persons Sold to | Price Per Share | Total |
|---------|--------|---------|--------------------------------|-----------------|----------|
| ---- | ----- | ----- | ----- | ----- | ----- |
| 6/5/03 | common | 46,000 | qualified investors | \$.25 | \$11,500 |
| 6/6/03 | common | 8,000 | qualified investor | \$.25 | 2,000 |
| 6/9/03 | common | 8,000 | qualified investor | \$.25 | 2,000 |
| 6/17/03 | common | 100,000 | qualified investor and insider | \$.25 | 25,000 |
| 6/23/03 | common | 20,000 | qualified investor | \$.25 | 5,000 |
| 6/26/03 | common | 20,000 | qualified investor | \$.25 | 5,000 |

The exemption relied upon for the issuance of the unregistered shares was that the shares were issued to qualified investors within the meaning of Securities and Exchange Commission Rule 501, Regulation D.

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

- 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.
- 99.2 Warrant Agreement dated March 31, 2004.
- 99.3 Amended and Restated Promissory Note dated March 19, 2004.
- 99.4 Loan Modification, Forbearance and Security Agreement dated March 19, 2004.

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, 2004

BIOMERICA, INC.

By: /S/ Zackary S. Irani

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Zackary S. Irani
Chief Executive Officer

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