Zacks Small-Cap Research

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Biomerica Inc (BMRA-OTCBB)

BMRA: Attractive Entry Point with BMRA Trading at Book Value

OUTLOOK

Revenue growth had recently softened but is bouncing back. We think this recent strength will continue, despite a huge recent hiccup in Asia sales – this should now be ironed out. New distribution in Europe and product launches have facilitated growth there. Meanwhile, U.S. sales have been less regular but we think will return to growth by late 2015. Could see a big-winner with new GI test (still under dvlmpnt). We continue to see very little to no downside risk in the share price at this level. The stock is now trading at book value and balance sheet remains very solid. We see only upside as revenue is now returning to positive growth.

Current Recommendation	**Buy**
Prior Recommendation	N/A
Date of Last Change	01/23/2013
Current Price (04/16/15)	$0.72
Target Price	**$2.10**

SUMMARY DATA

52-Week High	**$1.10**
52-Week Low	**$0.71**
One-Year Return (%)	**-8.55**
Beta	**0.74**
Average Daily Volume (sh)	**3,220**
Shares Outstanding (mil)	**8**
Market Capitalization ($mil)	**$6**
Short Interest Ratio (days)	**1.23**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**25**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**1.5**
Earnings Per Share (%)	**42.0**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2015 Estimate	**N/A**
P/E using 2016 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**High,**
Type of Stock	**Small-Value**
Industry	**Med-Drugs**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Aug)	Q2 (Nov)	Q3 (Feb)	Q4 (May)	Year (May)
2014	1.01 A	0.93 A	1.49 A	1.68 A	5.12 A
2015	1.03 A	1.13 A	1.30 A	1.47 E	4.94 E
2016					6.15 E
2017					7.70 E

Earnings per Share

	Q1 (Aug)	Q2 (Nov)	Q3 (Feb)	Q4 (May)	Year (May)
2014	-$0.02 A	-$0.03 A	$0.00 A	$0.02 A	-$0.03 A
2015	-$0.03 A	-$0.03 A	-$0.02 A	-$0.01 E	-$0.09 E
2016					-$0.01 E
2017					$0.06 E

Zacks Projected EPS Growth Rate - Next 5 Years % **NA**

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WHAT'S NEW……

Q3 Results: Sequential Revenue Growth Continues, Expect Even Stronger Q4…

Biomerica reported financial results for their fiscal third quarter ending February 2015. While revenue was down considerably from the year-earlier comparable period (i.e. yoy), it rebounded nicely from Q2 (i.e. sequentially). In addition Q3 saw a nice qoq resurgence from the company's key territories of the U.S. and Asia, despite certain short-term hindrances that are expected to reverse and benefit sales in Q4.

The recent relative strength in Asia-related sales is particularly encouraging as this had been a key component of the company's revenue growth through fiscal 2013 but which nosedived immediately afterwards as a result of a change in distributors. While Asia sales were down 2% on a yoy basis in Q3, they increased by over 200% from Q2 and have now grown on a sequential basis for two straight quarters. Indications in the earnings release were that Asia sales in Q3 would have been even stronger but certain orders that were placed in the quarter were not shipped until Q4 which should benefit that period.

While taking longer than initially anticipated, Asia sales are rebounding and we continue to see no reason why they will not eventually return to historical levels. As a reminder, Asia accounted for 43% of total revenue in 2013 when sales from that area were $2.8M, which compares to a current annual run-rate of just $657k (~15% of total sales). We currently model Asia sales of just better than $1M in the current fiscal year (including $526k in Q4) and have them nearing historical peak levels over the next three years. An earlier resurgence could provide potentially significant upside to our numbers.

Meanwhile, U.S. sales contracted by 31% on a yoy basis in Q3 but were slightly ahead of our estimate and jumped by 41% from Q2. BMRA notes that a screening program which uses the company's EZ Detect colon cancer test was pushed back from Q3 which negatively affected U.S. sales in the quarter – but, similar to the Asia revenue, this should benefit future periods.

Relative to Europe, sales have been more consistent then compared to either the U.S. or Asia but were down 2% yoy and down 15% sequentially. Sales in Europe have now contracted for two consecutive quarters. BMRA notes that their European distributor recently merged with another company which impacted sales of Biomerica's products but that the company expects this to reverse once the merger is fully integrated.

On the operational front, BMRA is moving further towards the possibility of bringing a new GI-related test to market. In January the company filed the first set of patents related to the product, which is an irritable bowel syndrome (IBS) related test. More recently they brought on a scientific advisory board to help further guide their strategy related to the pipeline candidate. The board includes Dr. Doug Drossman, an expert in IBS who has authored several articles and publications on the disorder.

While BMRA has remained largely tight-lipped about details of the IBS product as they lock down IP, based on public statements we think it may relate to a diagnostic for food allergens (i.e. diet) which may be responsible for onset or aggravation of IBS. This has been the subject of certain studies in the past (not related to BMRA) with at least some encouraging results although we know of no widely adopted test currently on the market that targets these types of markers. As such, and assuming positive development, BMRA may have a wide open audience for a diet-related IBS test. IBS is a large market, effecting over 15M people in the U.S. each year. It is also often misdiagnosed or underdiagnosed and is a disorder which is not fully understood, particularly the specific causes. Per Dr. Andrew Mullberg, a gastroenterologist with the FDA, "…researchers are more closely examining the role of diet in IBS causes and treatments." We hope to hear more about BMRA's IBS candidate in the near future as we continue to think the product could potentially be a big winner.

Financials
Q3 revenue of $1.3 million was up 15% sequentially but down 13% yoy and below our $1.5M estimate. The majority of the miss relative to our number was softer than anticipated European sales, partially offset by slightly stronger than modeled sales in the U.S. As noted, there were several short-term headwinds in the quarter that are expected to dissipate and we continue to look for sequential revenue growth in Q4.

We think European sales may turn in only single digit sequential growth over the next several periods although, as we have noted in the recent past, we think this could end up conservative, particularly if the recently signed distribution agreement is rolled out into other countries in Europe. We continue to look for U.S. sales to firm up in

the last quarter of the current year and maintain that momentum into fiscal 2016. Sales in Asia, as noted have exhibited recent relative strength which we also think continues as the new distributors gain further traction.

OpEx were $594k, just slightly higher than our $547k estimate and continue to come down as a percent of total revenue. Q3 OpEx were 46% of revenue, down from 49% in the prior quarter. Gross margin has also exhibited recent strength, coming in at 35% in Q3, inline with our 35% estimate and meaningfully better than the 27% in Q2. We continue to look for GM to widen further with growth in domestic sales.

The net result of a miss on revenue and mostly inline OpEx and GM resulted in a $105k (-$117k A vs -$12k E) miss on net income compared to our estimate. Q3 EPS came in at ($0.02), compared to our ($0.00) estimate.

Cash

The balance sheet remains solid. BMRA exited fiscal Q3 2015 with $1.2M in cash, down from $1.7M at the end of Q2. Q3 cash flow from operating activities was an outflow of $503k but ex-changes in working capital this was an outflow of just $48k. The balance sheet remains debt free. Book value at the end of fiscal Q3 stood at $5.3 million or approximately $0.71/share. We continue to believe that book value should put a floor on valuation of the company.

Maintaining Outlook / Recommendation

We continue to think sales to Asia will continue to rebound over the near term and will eventually return to legacy levels. The new product launches in China should be an additional facilitator to growth of sales in that country. We now look for European sales to begin to recover and turn back to positive growth in 2016 and remain the majority contributor to total sales. The recently penned new distribution agreement, particularly as it relates to EZ Detect, could further facilitate an uptick in European revenue. Meanwhile U.S. sales have already turned back to growth – at least on a sequential basis and we think yoy growth will materialize as soon as Q4 of this fiscal year.

We look for 2015 revenue and EPS of $4.9 million (-3%) and ($0.09) and for this to grow to $7.7 million and $0.08 in fiscal 2018. We are maintaining our Buy rating. Our price target is $2.10/share.

As we noted in our recent prior updates, over the mid-to-longer terms we think Biomerica will be looking to further exploit their existing technology. We view management's priorities as such that they will be focused on accelerating growth through bringing higher potential and novel products to market which we think likely fits into this growth strategy. We note that our current model does not incorporate an assumed contribution from "home run" type products - although we think given the company's expertise in certain disease areas (including GI, foodborne, women's health, and infectious disease), along with patentable and perhaps underexploited technology platforms and management's renewed focus on accelerating growth over the long-term, that big-winner type products could very well materialize over the coming years. The G.I. (IBS) product, still under development and for which U.S. patent applications were just recently filed, could potentially be a big-winner product – we will be eagerly awaiting further development updates on this product.

VALUATION / RECOMMENDATION

We use a comparable cohort of six companies of various market capitalizations in the medical diagnostics space with products/services that target the POC and/or clinical lab markets to value BMRA. Based on several metrics and excluding the low (and negative) and high values, BMRA is valued between $1.30 and $2.66 per share. Average is approximately $2.11/share.

The balance sheet remains solid. BMRA exited Q3 2015 with $1.2M in cash and equivalents and no debt. Book value at the end of fiscal Q3 2015 stood at $5.3 million or approximately $0.71/share. We continue to believe that book value should put a floor on valuation of the company.

We recommend buying the shares up to our $2.10/share target price and are maintaining our Buy rating.

Comparable Multiples

Ticker	P/E (ttm)	P/E (FY1)	P/E (FY4)	P/Book	EV / EBITDA (ttm)	P/S (ttm)	P/S (FY1)
TRIB	24.0	17.6	12.1	2.1	20.0	3.9	3.6
CEMI	N/A	N/A	10.0	2.1	N/A	1.5	1.5
VIVO	22.5	20.8	15.0	4.9	12.9	4.1	4.0
ERB	N/A	N/A	N/A	8.3	52.0	5.4	N/A
CONX	25.0	25.0	12.6	2.5	21.0	1.5	1.2
ABAX	74.0	51.0	32.9	6.9	33.6	7.1	6.7
Average	**36.4**	**28.6**	**16.5**	**4.5**	**21.9**	**3.9**	**3.6**

FY1, FY4 = forecast year 1, forecast year 4

Biomerica Stock Value Based On Comp:

	P/E (ttm)	P/E (FY1)	P/E (FY4)	P/Book	EV / EBITDA (ttm)	P/S (ttm)	P/S (FY1)	AVG
BMRA	~~$1.07~~	~~$2.54~~	$1.30	~~$3.37~~	~~$0.29~~	$2.66	$2.35	**$2.11**

FINANCIAL MODEL

Biomerica Inc.

	2014 A	Q1A	Q2A	Q3A	Q4E	2015 E	2016 E	2017 E	2018 E
Total Revenues	$5,120.4	$1,034.5	$1,133.6	$1,299.4	$1,474.4	$4,941.8	$6,147.8	$7,103.3	$7,707.1
YOY Growth	*-20.9%*	*2.0%*	*21.3%*	*-13.0%*	*-12.2%*	*-3.5%*	*24.4%*	*15.5%*	*8.5%*
Cost of Goods Sold	$3,451.2	$724.5	$826.4	$840.6	$952.4	$3,343.9	$3,928.4	$4,347.2	$4,678.2
Gross Income	$1,669.2	$309.9	$307.2	$458.8	$521.9	$1,597.9	$2,219.3	$2,756.1	$3,028.9
Gross Margin	*32.6%*	*30.0%*	*27.1%*	*35.3%*	*35.4%*	*32.3%*	*36.1%*	*38.8%*	*39.3%*
SG&A	$1,526.0	$338.3	$375.0	$409.7	$415.8	$1,538.8	$1,666.0	$1,719.0	$1,780.3
% SG&A	*29.8%*	*32.7%*	*33.1%*	*31.5%*	*28.2%*	*31.1%*	*27.1%*	*24.2%*	*23.1%*
R&D	$589.9	$195.7	$182.1	$184.6	$191.0	$753.4	$608.0	$522.0	$507.0
% R&D	*11.5%*	*18.9%*	*16.1%*	*14.2%*	*13.0%*	*15.2%*	*9.9%*	*7.3%*	*6.6%*
Operating Income	($446.6)	($224.1)	($249.9)	($135.5)	($84.8)	($694.4)	($54.7)	$515.1	$741.5
Operating Margin	*-8.7%*	*-21.7%*	*-22.0%*	*-10.4%*	*-5.8%*	*-14.1%*	*-0.9%*	*7.3%*	*9.6%*
Total Other Income (Expense)	$20.1	$4.8	$11.8	$1.7	$5.0	$23.4	$9.1	$14.2	$18.0
Pre-Tax Income	($426.5)	($219.3)	($238.0)	($133.8)	($79.8)	($671.0)	($45.6)	$529.3	$759.5
Tax expense (benefit)	($210.7)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$113.9
Tax Rate	*49.4%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*15.0%*
Net Income	($215.8)	($219.3)	($238.0)	($133.8)	($79.8)	($671.0)	($45.6)	$529.3	$645.6
YOY Growth	*448.9%*	*21.2%*	*20.1%*	*-95.0%*	*115.2%*	*210.9%*	*-93.2%*	*-1260.7%*	*22.0%*
Net Margin	*-4.2%*	*-21.2%*	*-21.0%*	*-10.3%*	*-5.4%*	*-13.6%*	*-0.7%*	*7.5%*	*8.4%*
EPS	($0.03)	($0.03)	($0.03)	($0.02)	($0.01)	($0.09)	($0.01)	$0.06	$0.08
YOY Growth	*440.0%*	*18.0%*	*55.8%*	*-95.0%*	*112.2%*	*203.5%*	*-93.7%*	*-1255.0%*	*21.2%*
Diluted Shares O/S	7,371	7,548	7,552	7,555	7,556	7,553	8,120	8,160	8,210

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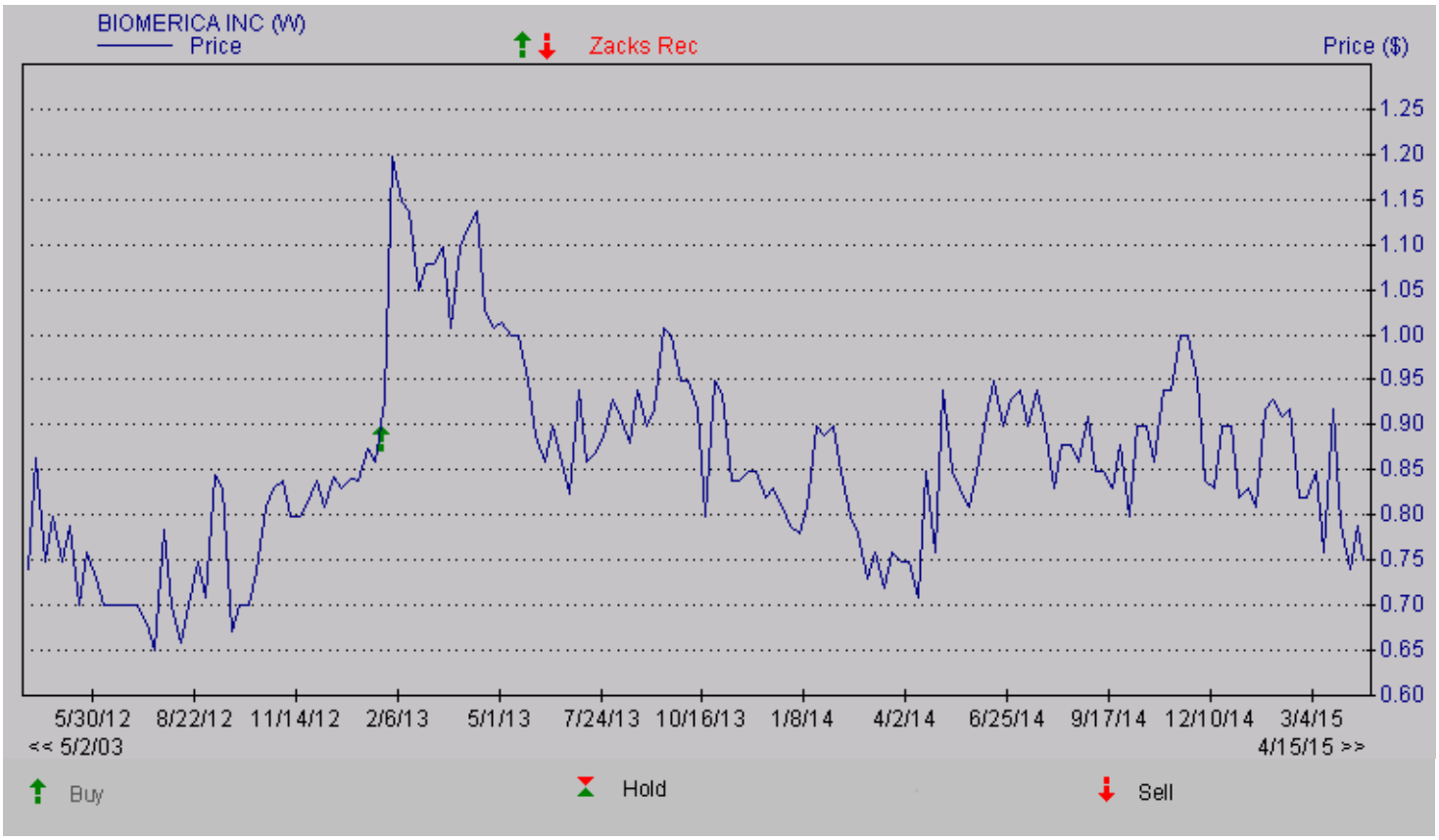

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