Zacks Small-Cap Research

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Biomerica Inc (BMRA-OTCBB)

BMRA: Q1: Decent Revenue If Not For Disappointing Asian Sales

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/23/2013
Current Price (10/16/14)	$0.86
Target Price	**$2.15**

OUTLOOK

Biomerica has been profitable twelve of the last sixteen quarters, has fairly regularly generated positive cash flow, and maintains a solid balance sheet. Revenue growth had recently softened but is bouncing back. We think this recent strength will continue, despite a huge hiccup in Asia sales in Q1. New distribution in Europe and product launches should facilitate growth there. Meanwhile, U.S. sales have remained strong. We continue to see very little to no downside risk in the share price at this level. We think the cheap valuation may have more to do with BMRA being a nano-cap and suffering from a lack of exposure rather than having anything to do with fundamentals.

SUMMARY DATA

52-Week High	**$1.10**
52-Week Low	**$0.69**
One-Year Return (%)	**23.83**
Beta	**0.81**
Average Daily Volume (sh)	**4,712**
Shares Outstanding (mil)	**8**
Market Capitalization ($mil)	**$7**
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 (%)	**3.3**
Earnings Per Share (%)	**39.1**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2015 Estimate	**N/A**
P/E using 2016 Estimate	**14.3**
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	1.30 E	1.78 E	2.20 E	6.30 E
2016					8.17 E
2017					9.49 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 E	-$0.01 E	$0.01 E	$0.02 E	-$0.01 E
2016					$0.06 E
2017					$0.12 E

Zacks Projected EPS Growth Rate - Next 5 Years % **19**

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WHAT'S NEW……

Q1 Results: Decent Revenue If Not For Hugely Disappointing China Sales

Biomerica filed their 10-Q for the fiscal 2015 first quarter ending August 30, 2014. Excluding China, revenue was up 16% yoy and 4% sequentially from fiscal Q4 2014. However, as China sales fell to just $16k from $136k in Q1 2014 and $701k in Q4 2014, yoy and sequential growth were 2% and negative 38%, respectively. The $16k in sales to China were the lowest since at least Q1 2010. China sales looked to be rebounding over the past few quarters as the company's new Chinese distributor began to gain traction. However, the most recent revenue figures suggest that there may still not be a consistent order flow from BMRA's marketing partner in Asia. We think it is worth noting, however, that sales to Asia have been highly volatile, particular more recently with the switch-up in distribution - and as such, we do not expect this low level of sales to persist.

Outside of Asia, Biomerica has other new irons in the fire to stoke additional growth, including the recent signing of a distribution agreement for the company's EZ Detect colorectal cancer test with a major (un-named) pharmaceutical company for a single European country (with the potential to expand into other countries throughout Europe). BMRA first announced their relationship with this pharma partner in January, noting that they would be selling two of Biomerica's POC tests. The company has also alluded to potential launch of products in Brazil and Mexico, as well as China, in 2015 where they are in the registration process. And in the U.S. BMRA is working towards FDA approval of a new GI test, which we had mentioned in earlier updates. In fact relatively elevated R&D expense as of late has been attributed to development of a new GI test.

Q1 revenue of $1.03M was down 38% sequentially, up 2% yoy and about 25% below our $1.38M estimate. While we had anticipated sales to Asia to fall sequentially, from $701k in Q4 to $382k in Q1, we clearly underestimated the actual decrease. Management noted in the earnings release that they were disappointed by the showing in China in Q1 but indicated that their distributor is optimistic that revenue will pick up.

Meanwhile, U.S. sales were $253k, down about 1% yoy and down 16% sequentially, but largely in-line with our estimate. We continue to think U.S. sales can turn in growth in the mid-teens % in the current fiscal year. And while U.S. and China sales have been somewhat soft recently, sales to Europe of $752k in Q1 represented yoy and sequential growth of 25% and 15%, respectively and were the highest since fiscal Q1 2014. We continue to model Europe sales growth in the low 20% for the full year 2015, catalyzed at least in part by the recent distribution agreement with the major pharma company.

The lower revenue figure, coupled with slightly higher opex as a percentage of sale as compared to our estimates resulted in a ~$98k miss on the bottom line. Q1 net income and EPS were ($219)k and ($0.03), compared to our ($121)k and ($0.03) estimate.

Cash
The balance sheet remains solid. BMRA exited fiscal Q1 2015 with $1.7M in cash, up from $1.5M at the end of fiscal 2014. Q1 cash flow from operating activities was $144k but ex-changes in working capital (which included a $675 decrease in A/R) this was an outflow of $154k. The balance sheet remains debt free. Book value at the end of fiscal Q1 stood at $5.7 million or approximately $0.76/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 rebound throughout the remainder of 2015 and think they could return to near legacy levels by fiscal year-end. The new product launches in China should be an additional facilitator to growth of sales in that country. We look for European sales to post more meaningful growth as a result of the recently penned new distribution agreement, particularly as it relates to EZ Detect. We also note that U.S.-based sales have been relatively strong and beat our estimates in every quarter of 2014.

We look for 2015 revenue and EPS of $6.3 million (+23%) and ($0.01) and for this to grow to $10.4 million and $0.12 in fiscal 2018. We are maintaining our Outperform rating. Our price target is $2.15/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.

BACKGROUND

For over 40 years Biomerica, Inc. (BMRA) has been involved in the development, manufacturing and marketing of medical diagnostics products for the early detection and monitoring of chronic diseases and medical conditions. Their product line encompasses various diseases and conditions including tests for gastrointestinal/foodborne diseases, infectious diseases, diabetes, women's health, hormone levels and even some esoteric diseases. The company's particular focus is on gastrointestinal/foodborne diseases and diabetes.

The tests are sold into two major market segments, clinical lab and point-of-care (POC). Demand for the clinical lab products mainly comes from hospitals and clinical and research laboratories. The POC segment, which may hold particularly attractive opportunities for growth given recent technological advancements which have significantly improved speed and accuracy of certain rapid tests, includes the over-the-counter retail channel as well as physician offices. Biomerica sells through distributors as well as directly. The majority of Biomerica's revenue is generated from international sales, particularly from Europe and Asia, while domestic sales account for approximately 20% - 25% of total revenue.

Biomerica recently divested the bulk of their internal research and development department in order to focus on a strategy of in-licensing technology and products from other companies, universities and institutions which they expect to result in a greater rate of revenue and earnings growth. The company, with headquarters and administrative offices in Southern California, maintains a portion of their manufacturing facilities in Mexico which helps reduce COGS and operating costs. Since the R&D divestiture in July 2010 BMRA has made meaningful progress in pursuing accelerated growth including the acquisition of several new high potential products as well as consummating additional distribution agreements.

Relative to their financials, revenue grew 24% in fiscal 2012 and was up 6% in 2013. While the first half of fiscal 2013 exhibited strong 19% growth, revenue in the second half contracted by 6%, largely due to a change in distributors in China. While we had expected the revenue contraction due to the swap in distributors in China to be a fairly short-term issue, weaker sales in Asia persisted during the first half of 2014 before rebounding nicely in last six months of the year.

Biomerica has been profitable over twelve of the last sixteen quarters, has fairly regularly generated positive cash flow (from both an operational cash flow and free cash flow standpoint), and maintains a solid balance sheet. Add to this the fact that executive compensation is relatively meager (possibly the lowest of any company we cover in the med-tech space), a minimal outstanding share count (7.7 million fully-diluted), and obvious diligence on growing revenue while leveraging their cost base and we think all this is clear evidence that management and the board lead the company in a way with an eye on increasing shareholder value. In our experience, we have come across few companies that have been in existence over 40 years (as BMRA has) and possess all of these positive characteristics yet trade at what we would characterize as an incredibly cheap valuation. As of today's market price BMRA is valued at just 1.1x book value.

Given that BMRA trades at book value, has liquid and high quality assets and no debt, and has generated positive cash flow on a fairly regular basis, we see very little to no downside risk in the share price at this level. We think the cheap valuation may have more to do with BMRA being a nano-cap and suffering from a lack of exposure rather than having anything to do with fundamentals. We think the current market value grossly undervalues the company and recommend accumulating the shares up to our $2.15 price target.

OUTLOOK

Revenue: *Asia Sales Should Rebound from Weakness Due To Change in Distributors - Look To Return To Legacy Levels. Near-to-Mid Term We Look For Europe to Return to Growth, Deeper Penetration Into S. America and Double-Digit Growth in U.S.*

We think Asia continues to be the major catalyst driving mid-term revenue growth as Biomerica expands both their geographic reach as well as their product menu throughout the continent, both key aspects to the company's growth strategy, particularly overseas. With Asia accounting for over 60% of the world's population and experiencing increasing demand for higher quality healthcare as a result of greater economic prosperity, an aging population (particularly in China due to their high birth rate after 1949 and one-child policy), and greater adoption of Western diets, Asia represents an under-served market with potentially very attractive opportunities for the foreseeable future.

Similar to Asia, parts of South America have benefitted from rapid economic growth and a resultant increased demand for better healthcare including earlier diagnosis and intervention. While Biomerica's revenue from South America has been minimal to-date, we expect the company will look to expand their presence there through additional distribution agreements and think over the mid-to-long term South America could be a meaningful contributor to revenue.

Europe accounts for ~40% - 50% of BMRA's revenue. European sales posted low double-digit growth in fiscal 2013 with management pointing to increased sales of products not purchased previously in Europe as the catalyst. Unfortunately this did not persist in 2014 with sales falling 14%. While the regulatory environment is significantly less stringent in most of Europe as compared to the U.S. relative to diagnostic tests, POC testing there is still largely in its infancy. The recent shift in greater (although still very modest) reliance on POC testing in some parts of Europe including Germany and the U.K. as a result of more emphasis on earlier diagnosis and prevention should offer greater opportunities for growth of both BMRA's POC and clinical lab products. In addition, Eastern Europe, which is more of an emerging territory with potentially less competition could provide opportunity for growth via bolt-on distribution. In January 2014 BMRA announced an agreement with a top-five pharmaceutical company to begin distributing some of its products in parts of Europe - this will also include the EZ Detect colon cancer test. This should also help catalyze further revenue growth in that continent. We think Europe can return to sustainable growth over the near to mid-term and model mid-teens revenue growth in Europe in 2015, falling to mid-to-high single digits thereafter.

In contrast to BMRA's international markets, growth in the U.S. has less to do with expanding distribution or their overall product portfolio and more to do with exploiting niche areas and potentially bringing some of their professional POC products to the OTC/retail channel and/or seeking CLIA waiver for some of their ASR tests (both of which would require additional regulatory approval). Product differentiation such as their more user friendly fecal occult blood test as well as offering a menu of more esoteric tests provides somewhat of a competitive barrier against their much larger and deeper entrenched peers. We expect this to continue to be a part of BMRA's domestic strategy. If the company can bring more of their existing tests to the POC channel, which is already a well-established part of the U.S. healthcare system, that could provide a real opportunity to grow domestic revenue. Another real opportunity for U.S. growth could be with potential partnerships or licensing agreements to supply ASR or CLIA-waived test kits to instrument manufacturers. Instrument manufacturers have a real interest expanding their testing menus as the more tests that can be run on each instrument can provide a significant competitive advantage - BMRA's more esoteric tests potentially offer valuable competitive differentiation.

Management Focused on Accelerating Growth Over Long-Term

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 - BMRA recently alluded to a GI product which we think likely fits into this growth strategy. And the introduction of additional tests to international markets as well as expanding distribution overseas should provide a base for longer-term growth. 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.

EPS: *Expect Growth Over Mid-to-Long Term*

The combination of revenue growth, incremental widening of GM and increased operating leverage should result in EPS growth. We model EPS to grow from ($0.03) in 2014 to ($0.01) in 2015 and to $0.12 in 2018.

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 $1.54 and $2.53 per share. Average is approximately $2.20/share.

The balance sheet remains solid. BMRA exited Q1 2015 with $1.7M in cash and equivalents and no debt. Book value at the end of fiscal Q1 2015 stood at $5.7 million or approximately $0.76/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 $2.15/share target price and are maintaining our Outperform 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	4.0	17.2	3.5	2.0	18.6	4.0	3.2
CEMI	1.2	N/A	11.5	1.9	32.7	1.2	1.4
VIVO	20.8	19.1	12.0	4.5	11.6	3.8	3.7
ERB	N/A	N/A	N/A	6.6	43.9	4.2	N/A
CONX	30.0	43.0	10.0	2.6	21.0	1.5	1.4
ABAX	69.0	39.0	25.1	5.5	31.0	6.0	5.0
Average	**25.0**	**29.6**	**12.4**	**3.8**	**23.0**	**3.5**	**3.0**

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	~~$0.73~~	~~$0.41~~	$1.54	~~$2.86~~	~~$0.31~~	$2.35	$2.53	**$2.14**

FINANCIAL MODEL

Biomerica Inc.

	2014 A	Q1A	Q2E	Q3E	Q4E	2015 E	2016 E	2017 E	2018 E
Total Revenues	$5,120.4	$1,034.5	$1,295.7	$1,780.9	$2,194.0	$6,305.1	$8,174.0	$9,486.0	$10,347.8
YOY Growth	*-20.9%*	*2.0%*	*38.6%*	*19.3%*	*30.7%*	*23.1%*	*29.6%*	*16.1%*	*9.1%*
Cost of Goods Sold	$3,451.2	$724.5	$848.7	$1,159.4	$1,417.3	$4,149.9	$5,166.0	$5,739.0	$6,208.7
Gross Income	$1,669.2	$309.9	$447.0	$621.5	$776.7	$2,155.1	$3,008.0	$3,747.0	$4,139.1
Gross Margin	*32.6%*	*30.0%*	*34.5%*	*34.9%*	*35.4%*	*34.2%*	*36.8%*	*39.5%*	*40.0%*
SG&A	$1,526.0	$338.3	$342.1	$432.8	$526.6	$1,639.7	$2,059.9	$2,200.7	$2,328.2
% SG&A	*29.8%*	*32.7%*	*26.4%*	*24.3%*	*24.0%*	*26.0%*	*25.2%*	*23.2%*	*22.5%*
R&D	$589.9	$195.7	$178.0	$144.0	$121.0	$638.7	$441.0	$408.0	$472.0
% R&D	*11.5%*	*18.9%*	*13.7%*	*8.1%*	*5.5%*	*10.1%*	*5.4%*	*4.3%*	*4.6%*
Operating Income	($446.6)	($224.1)	($73.0)	$44.8	$129.1	($123.3)	$507.2	$1,138.2	$1,338.9
Operating Margin	*-8.7%*	*-21.7%*	*-5.6%*	*2.5%*	*5.9%*	*-2.0%*	*6.2%*	*12.0%*	*12.9%*
Total Other Income (Expense)	$20.1	$4.8	$2.5	$4.0	$5.0	$16.3	$9.1	$14.2	$18.0
Pre-Tax Income	($426.5)	($219.3)	($70.5)	$48.8	$134.1	($107.0)	$516.3	$1,152.4	$1,356.9
Tax expense (benefit)	($210.7)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$172.9	$298.5
Tax Rate	*49.4%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*15.0%*	*22.0%*
Net Income	($215.8)	($219.3)	($70.5)	$48.8	$134.1	($107.0)	$516.3	$979.5	$1,058.4
YOY Growth	*448.9%*	*21.2%*	*651.0%*	*13.2%*	*16.0%*	*-50.4%*	*-582.7%*	*89.7%*	*8.0%*
Net Margin	*-4.2%*	*-21.2%*	*-5.4%*	*2.7%*	*6.1%*	*-1.7%*	*6.3%*	*10.3%*	*10.2%*
EPS	($0.03)	($0.03)	($0.01)	$0.01	$0.02	($0.01)	$0.06	$0.12	$0.12
YOY Growth	*440.0%*	*18.0%*	*703.8%*	*13.0%*	*17.0%*	*-52.3%*	*-536.6%*	*88.8%*	*7.4%*
Diluted Shares O/S	7,371	7,548	7,610	7,700	7,750	7,652	8,460	8,500	8,550

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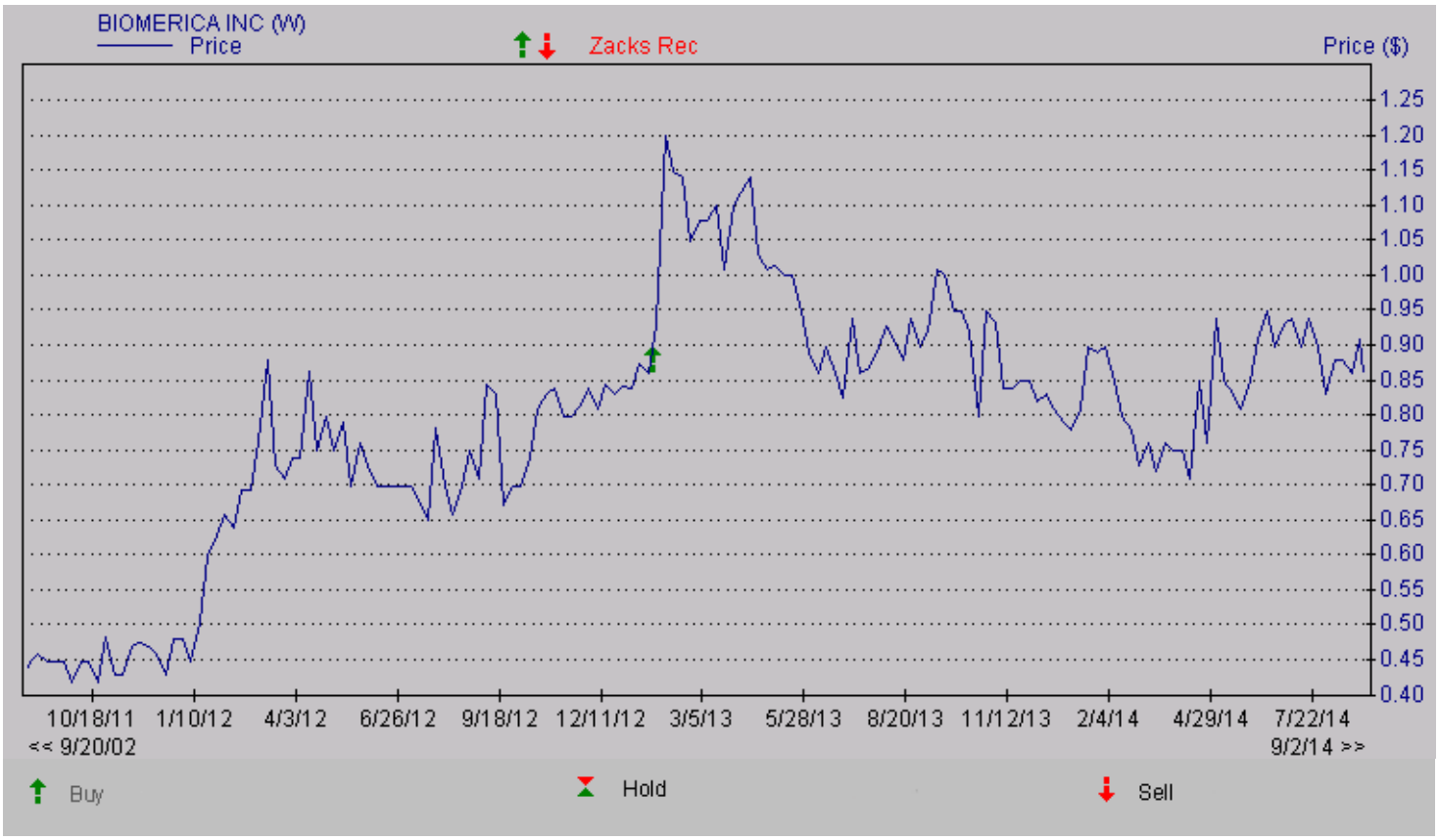
HISTORICAL ZACKS RECOMMENDATIONS



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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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