Zacks Small-Cap Research

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Biomerica Inc (BMRA-OTCBB)

BMRA: Rebound of Asian Sales Drives 3rd Straight Qtr of Sequential Revenue Growth

Current Recommendation	**Buy**
Prior Recommendation	N/A
Date of Last Change	01/23/2013
Current Price (09/02/15)	$0.77
Target Price	**$2.15**

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 softer and may continue to be so. 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.

SUMMARY DATA

52-Week High	**$1.44**
52-Week Low	**$0.70**
One-Year Return (%)	**-10.47**
Beta	**0.59**
Average Daily Volume (sh)	**4,913**
Shares Outstanding (mil)	**8**
Market Capitalization ($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 (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2016 Estimate	**N/A**
P/E using 2017 Estimate	**25.7**
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)
2015	1.03 A	1.13 A	1.30 A	1.50 A	4.96 A
2016	1.29 E	1.47 E	1.63 E	1.73 E	6.12 E
2017					7.10 E
2018					7.70 E

Earnings per Share

	Q1 (Aug)	Q2 (Nov)	Q3 (Feb)	Q4 (May)	Year (May)
2015	-$0.03 A	-$0.03 A	-$0.02 A	-$0.03 A	-$0.04 A
2016	-$0.02 E	-$0.02 E	-$0.00 E	$0.01 E	-$0.04 E
2017					$0.03 E
2018					$0.07 E

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

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WHAT'S NEW……

Q4 Results: Revenue Rebounding, Q4 Marks Third Straight Quarter of Sequential Growth…

Biomerica reported financial results for their fiscal fourth quarter ending May 2015. Results were mostly inline with our estimates with revenue and operating income coming in just about dead-on with our numbers. Q4 marks the third straight quarter of sequential revenue growth which has been mostly driven by rebounding sales in Asia. And while Q4 gross margin was softer than what we were looking for, this was offset by lower than estimated OpEx. Meanwhile a $315k reversal in income tax expense in the quarter pushed the company to positive net income and EPS in Q4.

Relative to the top-line, Asia-related sales continue to show growing strength, turning in the best quarter since fiscal Q4 2014 (May 2014) and the second best quarter since Q3 2013. While some of Asia revenue in Q4 2015 may have benefitted from product sold in Q3 but not shipped (and booked as revenue) until the most recent period, indications continue to point to a recovery in this region. In fact, BMRA notes in the 10-K that their Asian distributor "informed management that it anticipates improved sales results in (fiscal) 2016."

As we have noted in the past, while taking longer than initially anticipated, Asia sales have recently begun 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 fiscal 2013 when sales from that area were $2.8M, which compares to $1.0M, or just 21% of total revenue in 2015. But of this $1.0M in 2015, 88% was generated in the second half – which is indicative of the recent recovery. We currently model Asia sales of just better than $2M in 2016 and have them nearing historical peak levels in 2017.

Meanwhile U.S. sales have remained relatively tepid as a result of lower sales of the company's EZ Detect colon cancer test for screening programs. While indications were that a certain chain store delayed its screening program from Q3 to Q4, we think that based on the relatively poor showing of U.S. sales in Q4 (down 15% yoy and 17% sequentially), that perhaps this customer did not purchase at the level that had been anticipated. We have since downwardly adjusted our U.S. sales for 2016.

Relative to Europe, sales have been much more consistent than compared to either the U.S. or Asia. Sales in Europe were $685k in Q4, up 5% yoy and up 17% from Q3 – as a reminder, the company's European distributor recently merged with another company which, due to the integration process, had negatively impacted sales of Biomerica's products in that region. The relatively strong showing in Q4 may indicate that any lingering integration issues may now be less of a headwind - although we note we are taking somewhat of a cautious approach and modeling low single digit contraction for Europe sales in 2016. Europe has become a particularly important territory for BMRA, especially with the weakness in Asia, and accounted for more than 50% of the company's total revenue in 2015. Our numbers for 2016 could prove conservative and offer the potential for upside if sales in Europe continue to strengthen.

And BMRA may soon see significantly more sales coming from South America, which has historically generated very little in revenue for the company. South America sales were just $19k and $22k in fiscal 2014 and 2015, respectively, accounting for less than 1% of revenue in both periods. But with recent Brazilian regulatory approval of several of the company's products and a new distribution partner signed, South American sales could become more relevant.

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. The company held a conference call in early July, details of which we discuss below.

Financials

Q4 revenue of $1.5 million was up 12% sequentially but down 11% yoy and inline with our $1.5M estimate. While our total revenue estimate came in right on the reported number, there were some differences between our estimates and actuals in the geographic sources – with Europe beating our number by about $130k (24%), which was almost exactly offset by a miss in U.S. sales. As noted, the reduced purchasing of EZ Detect for a screening

program relates to the miss in the U.S. and a sooner than expected resurgence in Europe from distributor integration issues apparently being ironed out contributed to the beat in Europe.

OpEx were $527k, about 15% lower than our $607k estimate and down from $594k in Q3. At just 35% of revenue, total OpEx were the relatively (relative to sales) lowest since fiscal Q4 2013. OpEx, per the 10-K footnotes, benefitted at least in part to lower outside services costs as well as less bad debt expense. OpEx could increase considerably if and when BMRA pursues further development of the IBS test – we currently do not model either expenses or revenue related to the test as it is still in the feasibility stage – although we will update our model accordingly if and when appropriate. BMRA noted in the "subsequent events" section of the 10-K that their board of directors approved an agreement with an investment banker to raise up to $3M via the sale of restricted common stock – while not stated in the filing, this could potentially relate to initial funding of clinical studies in support of the IBS test development. We expect we'll hear more about the company's plans in this regard in the near future.

Meanwhile, gross margin was not particularly impressive, coming in at 31%, while we were looking for 35%. But, GM jumps around quite a bit from q-to-q (as an example, it was 35% in Q3) and we continue to look for GM to widen further with growth in domestic sales.

Excluding a $315k benefit from an income tax reversal, Q4 net loss and EPS were $55k and ($0.01), compared to our $80k loss and ($0.01) estimates.

Cash
The balance sheet remains solid. BMRA exited fiscal 2015 with $1.1M in cash, down only slightly from $1.2M at the end of Q3. Cash flow from operating activities in 2015 was $406k. The balance sheet remains debt free. Book value at the end of fiscal 2015 stood at $5.6 million or approximately $0.74/share. We continue to believe that book value should put a floor on valuation of the company.

IBS Test Conference Call

Biomerica recently held a conference call regarding its under-development irritable bowel syndrome (IBS) diagnostic. As a reminder, in January the company filed the first set of patents related to the product and, more recently, 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. Dr. Drossman is also the President of the Rome Foundation, a non-profit organization on the leading edge of GI disorder research and developer of the Rome III Questionnaire, which is a widely used clinical diagnostic for IBS. The advisory board, which also includes three other key opinion leaders in the GI and IBS field, will help guide BMRA through the FDA approval process.

BMRA has been largely tight-lipped about details of the IBS product as they lock down IP. And while management still didn't provide specifics (on such things as biomarkers) on this recent conference call (patents are still pending), they did confirm our prior suspicions that it is a diagnostic for food allergens (i.e. diet) which may be responsible for onset or aggravation of IBS. Additional details include;

- will identify certain trigger foods that may cause or exacerbate IBS symptoms
- will help physicians in guiding treatment protocol including putting the patient on a specific dietary regimen. This is different then other IBS tests which only focus on diagnosing presence of the disease. BMRA's test would be the first to both help diagnose IBS and to help guide treatment decisions
- test will be available for use in both the clinical lab and physician office settings
- would be reimbursed under existing CPT codes. As reimbursement is critical for maximizing early adoption, availability of payment under existing CPT codes is a significant benefit
- test is patent-pending at USPTO. BMRA has also filed for seven additional patents covering the technology

Zack Irani also did a nice job of framing the market opportunity for the test. Highlights of which included;

- Diagnostic cost of IBS in the U.S. is approximately $10.5B in annual direct costs and over $30B when including indirect costs
- IBS afflicts as much as 20% of the U.S. population, 25% of Japan, and 22%+ each of China and the U.K
- IBS is a top 10 reason for primary care doctor visits
- IBS is difficult to diagnose and difficult to treat

- Current diagnosis is more of ruling out other conditions than it is of a specific diagnosis for IBS
- A new blood-based test, recently highlighted on CBS nightly news in a segment titled *New tests offer hope for millions of patients with IBS*, has a false-negative rate of 56%. We think this highlights how elusive it has been to develop a reliable and effective IBS diagnostic. In addition, these new tests only aim to diagnose the disease but do not guide treatment decisions like BMRA's test is expected to do

As we noted in prior updates, we think having Dr. Drossman on board is a significant vote of confidence in the potential of BMRA's IBS product, which we continue to think could eventually be a big winner for the company. Once the initial patent is granted and published, we'll know more specifics about the test. We also expect management will be providing updates including more information as development of the product progresses.

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. Growth in Asian sales is what is driving almost all of our modeled top-line growth in 2016. And while we continue to look for European sales to be a significant contributor to total revenue, we are hesitant to model much more in the way of growth from current levels – this could prove to be a conservative outlook and will be updated if appropriate. Meanwhile U.S. sales have been disappointing, falling 17% in 2015 – which likely relates, at least in part, to softer sales of EZ Detect. As noted, we have trimmed our sales outlook for the U.S. Some of the weakness in the U.S. may be offset by increasing, and potentially much more substantial, sales in South America – although we currently model South America to only grow to about 1.5% of total revenue in 2016 – this is another territory that could outperform our estimates.

We look for 2016 revenue and EPS of $6.1 million (+23%) and ($0.04) and for this to grow to $8.5 million and $0.09 in fiscal 2019. We are maintaining our Buy 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. 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 five 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 negative values, BMRA is valued between $1.12 and $2.68 per share. Average is approximately $2.16/share.

The balance sheet remains solid. BMRA exited fiscal 2015 with $1.1M in cash and equivalents and no debt. Book value at the end of fiscal 2015 stood at $5.6 million or approximately $0.74/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 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	24.1	22.7	12.8	1.6	17.7	3.2	2.7
CEMI	N/A	N/A	9.0	2.2	N/A	1.5	1.4
VIVO	21.9	19.8	11.0	4.5	12.0	4.0	3.4
ERB	N/A	N/A	N/A	5.1	NA	3.6	N/A
ABAX	36.0	31.0	16.6	4.7	22.0	5.1	4.5
Average	**27.3**	**24.5**	**12.3**	**3.6**	**17.2**	**3.5**	**3.1**

FY1, FY4 = forecast year 1, forecast year 4

Value Based On Comp:

	P/E (ttm)	P/E (FY1)	P/E (FY4)	P/Book	P/S (ttm)	P/S (FY1)	AVG
BMRA	-$0.80	-$0.99	$1.12	$2.68	$2.35	$2.51	**$2.16**

FINANCIAL MODEL

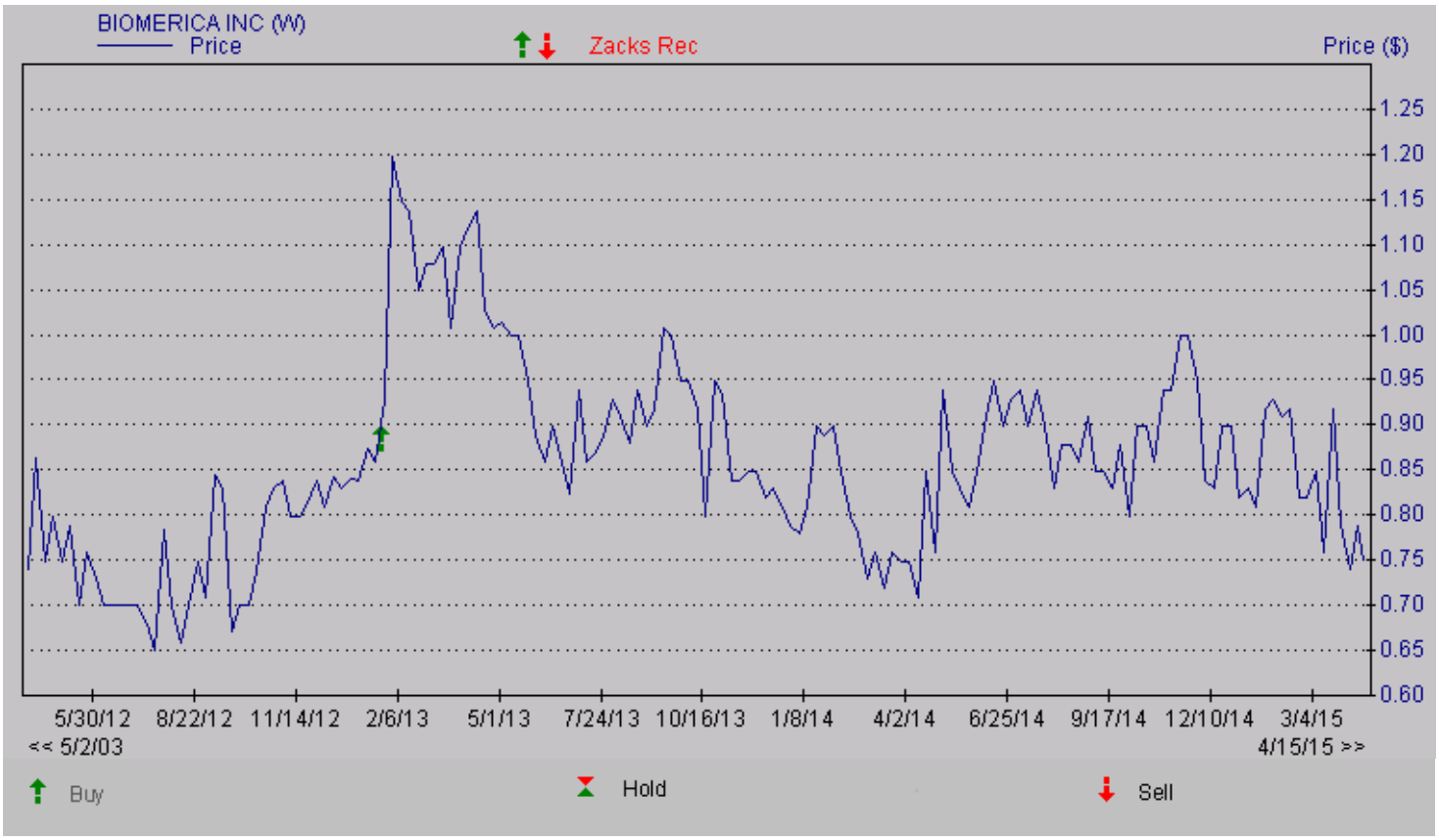
Biomerica Inc.

	2015 A	Q1E	Q2E	Q3E	Q4E	2016 E	2017 E	2018 E	2019 E
Total Revenues	$4,962.4	$1,291.5	$1,468.3	$1,626.5	$1,732.4	$6,118.7	$7,102.9	$7,701.9	$8,539.6
YOY Growth	*-3.1%*	*24.8%*	*29.5%*	*25.2%*	*15.9%*	*23.3%*	*16.1%*	*8.4%*	*10.9%*
Cost of Goods Sold	$3,420.6	$883.4	$995.5	$1,044.2	$1,136.4	$4,059.5	$4,538.7	$4,713.5	$5,200.6
Gross Income	$1,541.8	$408.1	$472.8	$582.3	$595.9	$2,059.1	$2,564.1	$2,988.3	$3,339.0
Gross Margin	*31.1%*	*31.6%*	*32.2%*	*35.8%*	*34.4%*	*36.1%*	*36.1%*	*38.8%*	*39.1%*
SG&A	$1,478.8	$390.0	$421.4	$439.2	$434.8	$1,685.4	$1,718.9	$1,779.1	$1,853.1
% SG&A	*29.8%*	*30.2%*	*28.7%*	*27.0%*	*25.1%*	*27.1%*	*24.2%*	*23.1%*	*21.7%*
R&D	$733.6	$181.0	$176.0	$183.0	$165.0	$705.0	$631.0	$588.0	$622.0
% R&D	*14.8%*	*14.0%*	*12.0%*	*11.3%*	*9.5%*	*11.5%*	*8.9%*	*7.6%*	*7.3%*
Operating Income	($670.6)	($162.9)	($124.6)	($39.9)	($3.9)	($331.3)	$214.2	$621.2	$863.9
Operating Margin	*-13.5%*	*-12.6%*	*-8.5%*	*-2.5%*	*-0.2%*	*-5.4%*	*3.0%*	*8.1%*	*10.1%*
Total Other Income (Expense)	$24.1	$4.5	$4.5	$4.5	$4.5	$18.0	$14.2	$18.0	$24.0
Pre-Tax Income	($646.5)	($158.4)	($120.1)	($35.4)	$0.6	($313.3)	$228.4	$639.2	$887.9
Tax expense (benefit)	($315.0)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$95.9	$133.2
Tax Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*15.0%*	*15.0%*
Net Income	($331.5)	($158.4)	($120.1)	($35.4)	$0.6	($313.3)	$228.4	$543.3	$754.7
YOY Growth	*53.6%*	*-25.6%*	*-88.1%*	*37.9%*	*78.2%*	*-5.5%*	*-172.9%*	*137.8%*	*38.9%*
Net Margin	*-6.7%*	*-12.3%*	*-8.2%*	*-2.2%*	*0.0%*	*-5.1%*	*3.2%*	*7.1%*	*8.8%*
EPS	($0.04)	($0.02)	($0.02)	($0.00)	$0.00	($0.04)	$0.03	$0.07	$0.09
YOY Growth	*49.9%*	*-25.9%*	*-90.6%*	*38.4%*	*78.2%*	*-8.1%*	*-169.4%*	*136.4%*	*37.4%*
Diluted Shares O/S	7,552	7,580	7,760	7,825	7,905	7,768	8,160	8,210	8,300

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