BIOMERICA INC
Form 10KSB
August 29, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-KSB

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES AND EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED MAY 31, 2006 COMMISSION FILE NUMBER: 0-8765

BIOMERICA, INC.

(Small Business Issuer in its Charter)

DELAWARE	95-2645573
(State or other jurisdiction of Identification No.)	(I.R.S. Employer incorporation or organization)
1533 MONROVIA AVENUE, NEWPORT BEACH, CA	92663
(Address of principal executive offices)	(Zip Code)

Issuer's Telephone Number:
(949) 645-2111

Securities registered under Section 12(b) of the Exchange Act:

(Title of each class)	(Name of each exchange on which registered)
NONE	OTC-BULLETIN BOARD

Securities registered under Section 12(g) of the Exchange Act:

(Title of each class)

COMMON STOCK, PAR VALUE $0.08

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 [X] No [ ]

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained herein, and will not be contained, to the best of issuer's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [X]

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

State issuer's revenues for its most recent fiscal year: $7,184,992.

State the aggregate market value of the voting and non-voting stock held by non-affiliates of the issuer (based upon 4,766,910 shares held by non-affiliates and the closing price of $0.53 per share for Common Stock in the over-the-counter market as of July 17, 2006): $2,526,462.

Number of shares of the issuer's common stock, par value $0.08, outstanding as of August 27, 2006: 5,922,681.

DOCUMENTS INCORPORATED BY REFERENCE: none

Transitional Small Business Disclosure Format YES [ ] NO [X]

PART I*

ITEM 1. DESCRIPTION OF BUSINESS

BUSINESS OVERVIEW

THE COMPANY

Biomerica, Inc. ("Biomerica", the "Company", "we" or "our") was incorporated in Delaware in September 1971 as Nuclear Medical Systems, Inc. We changed our corporate name in February 1983 to NMS Pharmaceuticals, Inc., and in November 1987 to Biomerica, Inc. During the first two quarters of fiscal 2006 and all of fiscal 2005 we had one operational subsidiary, Lancer Orthodontics, Inc. ("Lancer"), an international manufacturer of orthodontic products.

Biomerica develops, manufactures, and markets medical diagnostic products designed for the early detection and monitoring of chronic diseases and medical conditions. Lancer is engaged in the design, manufacture and distribution of orthodontic products. As of May 31, 2005, Biomerica's direct ownership percentage of Lancer was 23.41% and its direct and indirect (via agreements with certain shareholders/directors) voting control over Lancer was greater than 50%. As a result of Biomerica's control and ownership, our financial statements were consolidated with those of Lancer. During the fiscal year ended May 31, 2005, Biomerica was a party to certain informal agreements with certain of Lancer's officers and directors, pursuant to which they agreed to vote in the same manner as Biomerica (and its directors holding shares of Lancer's common stock) on matters requiring the approval of Lancer's stockholders. Biomerica's percentage of direct ownership in Lancer continued to decrease due to Lancer's issuance of additional shares of its common stock. As of December 1, 2005, the above-mentioned board members reserved their right no longer to vote their shares of Lancer in the same manner as the Biomerica board votes Biomerica's shares of Lancer. Therefore, effective as of December 1, 2005, Lancer's financial statements were no longer consolidated with those of Biomerica because Biomerica no longer has direct or indirect control of more than 50% of Lancer's common stock. As of December 1, 2005, Biomerica held less than 20% of Lancer's common stock and therefore Biomerica's investment is accounted for under the provisions of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities".

The Company adopted a formal plan in April 2001 to discontinue operations of its ReadyScript subsidiary. Certain assets were written off during the closure and subsequently were recorded as losses in the consolidated

financial statements. During the fiscal years ended May 31, 2006 and 2005 certain liabilities were forgiven and thus ReadyScript recorded income for the years then ended. The subsidiary is being reported in the financial statements as a discontinued operation because it is no longer an operating entity.

OUR MEDICAL DEVICE BUSINESS

During fiscal 2006, our existing medical device business was conducted through two companies: (1) Biomerica, Inc., engaged in the human diagnostic products market and (2) (for the period June 1 through November 30, 2005) Lancer Orthodontics, Inc., engaged in the orthodontic products market.

BIOMERICA - DIAGNOSTIC PRODUCTS

Biomerica develops, manufactures, and markets medical diagnostic products designed for the early detection and monitoring of chronic diseases and medical conditions. The Company's medical diagnostic products are sold worldwide in three markets: 1) clinical laboratories, 2) physicians offices and 3) over-the-counter (drugstores). Our diagnostic test kits are used to analyze blood or urine from patients in the diagnosis of various diseases and other medical complications, or to measure the level of specific hormones, antibodies, antigens or other substances, which may exist in the human body in extremely small concentrations.

Technological advances in medical diagnostics have made it possible to perform diagnostic tests within the home and the physician's office, rather than in the clinical laboratory. One of our main objectives has been to develop and market rapid diagnostic tests that are accurate, employ easily obtained specimens, and are simple to perform without instrumentation. Our over-the-counter and professional rapid diagnostic products help to manage existing medical conditions and may save lives through prompt diagnosis and early detection. Until recently, tests of this kind required the services of medical technologists and sophisticated instrumentation. Frequently, results were not available until at least the following day. We believe that rapid point of care tests are as accurate as laboratory tests when used properly and they require no instrumentation, give reliable results in minutes and can be performed with confidence in the home or the physician's office.

Our clinical laboratory diagnostic products include tests for thyroid conditions, food allergies, H. pylori, diabetes and others. These diagnostic test kits utilize enzyme immunoassay or radioimmunoassay technology. Some of these products have not yet been submitted for clearance by the FDA for diagnostic use, but can be sold in various foreign countries.

A large part of Biomerica's manufacturing operations are located in Mexicali, Mexico, in order to reduce the cost of manufacturing and compete more effectively worldwide. Biomerica maintains its headquarters in Newport Beach, California where it houses administration, research and development, sales and marketing, and customer services.

Biomerica has undergone no material change in the mode of conducting its business other than as described above and it did not dispose of any material amount of its assets during the fiscal year ended May 31, 2006.

LANCER ORTHODONTICS, INC. -- ORTHODONTIC PRODUCTS

Lancer is engaged in developing, manufacturing, and selling orthodontic products. Its products are sold worldwide through a direct sales force and distributors. Lancer conducts its operations at two facilities, one of which is located at 253 Pawnee Street, San Marcos, California 92069-2347 and the other in Mexicali, Mexico.

Effective December 1, 2005 the operations of Lancer Orthodontics were no longer consolidated with those of Biomerica. The consolidated income statement for the year ended May 31, 2006 includes the operations of Lancer Orthodontics for the period of June 1, 2005 through November 30, 2005. The balance sheet as of May 31, 2006 does not include any assets or liabilities of Lancer Orthodontics, except for the long-term available-for-sale securities that Biomerica holds in Lancer Orthodontics. This is included in non-current assets in the Biomerica balance sheet.

DISCONTINUED OPERATIONS

Biomerica's ReadyScript subsidiary was a development-stage enterprise and required the raising of a significant amount of capital to fund its short-term working capital needs. The ReadyScript operations were discontinued in May 2001. The net liabilities and operating results of ReadyScript are shown separately in the accompanying consolidated financial statements as discontinued operations.

LIQUIDITY AND 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 losses and negative cash flows from operations. Biomerica's shareholder's line of credit expired on September 13, 2003 and was not renewed. The unpaid principal and interest was converted into a note payable in the amount of $313,318 bearing interest at 8% and payable September 1, 2004. The due date on this note was extended until September 1, 2005 and subsequently to September 1, 2006 at the same terms. Minimum payments of $4,000 per month plus an additional $3,500 per month, depending on quarterly results of the Company, are being made. Although the Company is currently out of compliance with the terms of the loan agreement, in August 2006 the note holder agreed to extend the due date on the note payable until September 1, 2007. The terms of the note are the same except that additional payments of $3,500 per month, depending on quarterly results of the Company, have been reduced to $2,000 per month. Of the additional payments of $10,500 per quarter due for the quarters ended August 31, 2005, November 30, 2005 and February 28, 2006, only a total of $5,250 has been paid.

Until two years ago Biomerica had suffered substantial recurring losses from operations. Biomerica has funded its operations through profits as well as debt and equity financings for the past two years. ReadyScript operations were discontinued in May 2001. ReadyScript was a contributor to the Company's losses in prior fiscal years. During the fiscal years ended May 31, 2006 and 2005, certain ReadyScript liabilities were forgiven and thus income from discontinued operations for the years then ended was recorded. The subsidiary is being reported in the financial statements as a discontinued operation because it is no longer an operating entity.

In the last several years the Company has been focusing on reducing costs where possible and concentrating on its core business to increase sales. Management believes that cash flows from current operations will be sufficient to fund operations for at least the next twelve months. Should the Company have a downturn in sales or unanticipated, increased expenses, the result for the Company could be the inability to continue as a going concern. The Company will continue to have limited cash resources. Biomerica, as a parent entity, has no open or existing, operating line of credit or loans on which it can draw any new

or additional debt financing, however management is currently investigating the possibility of obtaining a line of credit from a bank.

Our independent registered public accounting firm has concluded that there is 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 report 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.

PRODUCTION

Most of our diagnostic test kits are processed and assembled at our facilities in Newport Beach, California and in Mexicali, Mexico. During fiscal 2003, the diagnostics division established a manufacturing facility in Mexicali, Mexico, in a building that we share with Lancer Orthodontics. We have moved a significant portion of our diagnostic manufacturing to that facility. We subcontract with Lancer to provide labor and other services. Production of diagnostic tests can involve formulating component antibodies and antigens in specified concentrations, attaching a tracer to the antigen, filling components into vials, packaging and labeling. We continually engage in quality control procedures to assure the consistency and quality of our products and to comply with applicable FDA regulations.

All manufacturing production is regulated by the FDA Good Manufacturing Practices for medical devices. We have an internal quality control unit that monitors and evaluates product quality and output. We also have an internal Quality Systems department which insures that our operating procedures are in compliance with current FDA and ISO regulations. We either produce our own antibodies and antigens or purchase these materials from qualified vendors. We have alternate, approved sources for raw materials procurement and we do not believe that material availability in the foreseeable future will be a problem.

RESEARCH AND DEVELOPMENT

Biomerica is engaged in research and development to broaden its diagnostic product line in specific areas. Research and development expenses include the costs of materials, supplies, personnel, facilities and equipment as well as outside contract services.

Consolidated research and development expenses incurred by Biomerica for the years ended May 31, 2006 and 2005 aggregated $239,344 and $274,288, respectively. Of the above expenses approximately $42,000 and $96,000 for the first half of fiscal 2006 and all of fiscal 2005, respectively, are for Lancer's product development.

MARKETS AND METHODS OF DISTRIBUTION

Biomerica has approximately 450 current customers for its diagnostic business, of which approximately 100 are distributors and the balance are hospital and clinical laboratories, medical research institutions, medical schools, pharmaceutical companies, chain drugstores, wholesalers and physicians' offices.

We rely on unaffiliated distributors, advertising in medical and trade journals, exhibitions at trade conventions, direct mailings and an internal sales staff to market our diagnostic products. We target three main markets: (a) clinical laboratories, (b) physicians' offices, and (c) over-the-counter drug stores. Separate marketing plans are utilized in targeting each of the three markets.

On a consolidated basis no customer accounted for 10% or more of the consolidated sales in the fiscal years ended May 31, 2006 and 2005. No customer accounted for 10% or more of Lancer Orthodontics' sales for the fiscal year ended May 31 2005. On an unconsolidated basis Biomerica has two customers each of which account for greater than 10% of its sales for the years ended May 31, 2006 and 2005.

BACKLOG

At May 31, 2006 and 2005 Biomerica had a backlog of approximately $234,000 and $203,000 respectively. As of May 31, 2005, Lancer had a backlog of approximately $86,000. Biomerica's business is not subject to significant seasonal fluctuations.

RAW MATERIALS

The principal raw materials utilized by Biomerica consist of various chemicals, serums, reagents and packaging supplies. Almost all of our raw materials are available from several sources, and we are not dependent upon any single source of supply or a few suppliers. No company accounted for more than 10% of the consolidated purchases for the years ended May 31, 2006 and 2005. For the year ended May 31, 2006 one company accounted for more than 10% of the purchases for Biomerica on an unconsolidated basis and for the fiscal year ended May 31, 2005 two companies each of which accounted for more than 10% of the purchases for Biomerica on an unconsolidated basis.

We maintain inventories of antibodies and antigens as components for our diagnostic test kits. Some sales orders are processed on the day received while others are processed at a later date depending on the quantity and type of order.

COMPETITION

Immunodiagnostic products are currently produced by more than 100 companies. Biomerica is not a significant factor in the market.

Our competitors vary greatly in size. Many are divisions or subsidiaries of well-established medical and pharmaceutical concerns which are much larger than Biomerica and expend substantially greater amounts than we do for research and development, manufacturing, advertising and marketing.

The primary competitive factors affecting the sale of diagnostic products are uniqueness, quality of product performance, price, service and marketing. We believe we compete primarily on the basis of the uniqueness of our products, the quality of our products, the speed of our test results, our patent position, our favorable pricing and our prompt shipment of orders. We offer a broader range of products than many competitors of comparable size, but to date have had limited marketing capability. We are working on expanding this capability through marketing and strategic cooperations with larger companies

and distributors.

GOVERNMENT REGULATION OF OUR DIAGNOSTIC BUSINESS

As part of our diagnostic business, we sell products that are legally defined to be medical devices. As a result, we are considered to be a medical device manufacturer, and as such are subject to the regulations of numerous governmental entities. These agencies include the Food and Drug Administration (the "FDA"), the United States Drug Enforcement Agency (the "DEA"), Environmental Protection Agency, Federal Trade Commission, Occupational Safety and Health Administration, U.S. Department of Agriculture ("USDA"), and Consumer Product Safety Commission. These activities are also regulated by various agencies of the states and localities in which our products are sold. These regulations govern the introduction of new medical devices, the observance of certain standards with respect to the manufacture and labeling of medical devices, the maintenance of certain records and the reporting of potential product problems and other matters.

The Food, Drug & Cosmetic Act of 1938 (the "FDCA") regulates medical devices in the United States by classifying them into one of three classes based on the extent of regulation believed necessary to ensure safety and effectiveness. Class I devices are those devices for which safety and effectiveness can reasonably be ensured through general controls, such as device listing, adequate labeling, pre-market notification and adherence to the Quality System Regulation ("QSR") as well as Medical Device Reporting (MDR), labeling and other regulatory requirements. Some Class I medical devices are exempt from the requirement of Pre-Market Approval ("PMA") or clearance. Class II devices are those devices for which safety and effectiveness can reasonably be ensured through the use of special controls, such as performance standards, post-market surveillance and patient registries, as well as adherence to the general controls provisions applicable to Class I devices. Class III devices are devices that generally must receive pre-market approval by the FDA pursuant to a pre-market approval application to ensure their safety and effectiveness. Generally, Class III devices are limited to life-sustaining, life-supporting or implantable devices. However, this classification can also apply to novel technology or new intended uses or applications for existing devices. The Company's products are primarily either Class I or Class II medical devices. The following is a breakdown of the Biomerica products by class:

Class I - Fortel(TM) Ovulation test, EZ-LH(TM) Rapid Ovulation test

Class II - GAP(tm) IgG H. Pylori ELISA kit, Anti-thyroglobulin ELISA kit, anti-TPO ELISA kit, PTH (intact) ELISA kit, Calcitonin ELISA kit, Erythropoietin ELISA kit, ACTH ELISA kit, Fortel Ultra Midstream (OTC and plastic stick), EZ-HCG(tm) Rapid Pregnancy test (professional and dipstick), EZ Detect(tm) Fecal Occult Blood test (Physician's dispenser pack and OTC), Aware(tm) Breast Self-Examination, drugs of abuse rapid tests, EZ-HP Professional, PTH (intact) IRMA kit, GAP(tm) IgA H. Pylori ELISA kit, C-Peptide ELISA kit, Myoglobin ELISA, Troponin I ELISA, HS-CRP ELISA.

Class III - GAP(tm) IgM H. Pylori ELISA kit, Isletest(tm) GAD ELISA kit, Isletest(tm) ICA ELISA kit, Isletest(tm) IAA ELISA kit, Allerquant(tm) IgG Food Allergy ELISA kit, Allerquant(tm) Med90G, Allerquant(tm) 14 Foods, Custom Food Allergy Kit, Candiquant(tm) IgG ELISA kit, Candiquant(tm) IgM ELISA kit, Candiquant(tm) IgA ELISA kit, EZ-HP OTC, EZ PSA (Professional and OTC).

If the FDA finds that the device is not substantially equivalent to a predicate device, the device is deemed a Class III device, and a manufacturer or seller is required to file a PMA application. Approval of a PMA application for a new medical device usually requires, among other things, extensive clinical data on the safety and effectiveness of the device. PMA applications may take years to be approved after they are filed, but approval is required before the product can be sold for general use in the U.S. In addition to requiring clearance or approval for new medical devices, FDA rules also require a new 510(k) filing and review period, prior to marketing a changed or modified version of an existing legally marketed device, if such changes or modifications could significantly affect the safety or effectiveness of that device. The FDA prohibits the advertisement or promotion or any approved or cleared device for uses other than those that are stated in the device's approved or cleared application.

Pursuant to FDA requirements, we have registered our manufacturing facility with the FDA as a medical device manufacturer, and listed the medical devices we manufacture. We are also subject to inspection on a routine basis for compliance with FDA regulations. This includes the Quality System Requirements, which requires that we manufacture our products and maintain our documents in a prescribed manner with respect to issues such as design controls, manufacturing, testing and validation activities. Further, we are required to comply with other FDA requirements with respect to labeling, and the Medical Device Reporting (MDR) regulation which requires that we provide information to the FDA on deaths or serious injuries alleged to have been associated with the use of our products, as well as product malfunctions that are likely to cause or contribute to death or serious injury if the malfunction were to recur. We believe that we are currently in material compliance with all relevant QSR and MDR requirements.

In addition, our facility is required to have a California Medical Device Manufacturing License. The license is not transferable and must be renewed annually. Approval of the license requires that we be in compliance with QSR, labeling and MDR regulations. Our license expires on March 16, 2007. We also hold two radioactive materials licenses from the State of California (both expiring on June 20, 2008), and one permit from the USDA, expiring on August 25, 2007. These licenses are renewed periodically, and to date we have never failed to obtain a renewal.

Through compliance with FDA and California regulations, we can market our medical devices throughout the United States. International sales of medical devices are also subject to the regulatory requirements of each country. In Europe, the regulations of the European Union require that a device have a "CE Mark" in order to be sold in EU countries. The directive went into effect beginning December 7, 2003. The Company has completed the process for complying with the "CE Mark" directives, In Vitro Directive 98/79/EC, ISO 13485 for medical devices, and Medical Device Directive 93/42/EEC. At present the regulatory international review process varies from country to country. We, in general, rely upon our distributors and sales representatives in the foreign countries in which we market our products to ensure that we comply with the regulatory laws of such countries. We believe that our international sales to date have been in compliance with the laws of the foreign countries in which we have made sales. Exports of most medical devices are also subject to certain FDA regulatory controls.

The following products are FDA-cleared and may be sold to clinical laboratories, physician laboratories and/or retail outlets in the United States as well as internationally:

Anti-thyroglobulin ELISA kit
Anti-TPO ELISA Kit
GAP IgG H. Pylori ELISA Kit
PTH(Intact) ELISA Kit

Calcitonin ELISA Kit
Erythropoietin ELISA Kit
ACTH ELISA Kit
Myoglobin ELISA
Troponin I ELISA
HS-CRP ELISA
EZ-HCG Rapid Pregnancy Test
EZ-LH(tm) Rapid Ovulation Test
EZ Detect(tm) Fecal Occult Blood Test(Physician's package, OTC package)
AWARE(tm)
Breast Self-Examination Kit
Drugs-of-Abuse Rapid Tests

The following products are not FDA-cleared. These are sold internationally and can be sold in the U.S. "FOR RESEARCH ONLY":

GAP(tm) IgM H. Pylori ELISA Kit
GAP(tm) IgA H. Pylori ELISA Kit
Isletest(tm) GAD ELISA Kit
Isletest(tm) ICA ELISA Kit
Isletest(tm) IAA ELISA Kit
C-Peptide ELISA Kit
Allerquant(tm) IgG Food Allergy ELISA Kit (90-foods, 14-foods, custom kits)
Candiquant(tm) IgG, IgM, and IgA ELISA Kits for Candida Albicans antibodies
Fortel(tm) Ultra Midstream Pregnancy Test
Fortel(tm) Ovulation Test EZ-PSA Rapid
Test EZ-H. Pylori Rapid Test

Biomerica is licensed to design, develop, manufacture and distribute IN VITRO diagnostic and medical devices and is subject to the Code of Federal Regulations, Section 21, parts 800 - 1299. The FDA is the governing body that assesses and issues Biomerica's license to assure that it complies with these regulations. Biomerica is currently licensed, and its last assessment was in March 2006. During the inspection the FDA noted five observations that required correction. Management made a commitment to correct all of these observations within six weeks of the date of inspection, and has notified the FDA that it has done so. Biomerica is also registered and licensed with the State of California's Department of Health Services. The Company believes that all Biomerica products sold in the U.S. comply with the FDA regulations.

Biomerica's Quality Management System is in compliance with the International Standards Organization (ISO) EN ISO 13485:2003. EN ISO 13485:2003 is an internationally recognized standard in which companies establish their methods of operation and commitment to quality.

Effective December 2003, fifteen major European countries require a CE (European Community) certification to sell products within their countries. The European Community Directive 98/79/EC is the IN VITRO Device Directive (IVDD), which regulates the import and sale of IN VITRO devices in the countries that comprise the European Community. In order for Biomerica's products to be sold within the European Community with the CE Mark, a Notified Body (TUV Rheinland) assessed Biomerica's compliance to the IVDD in October of 2003, and the Company was issued approval according to Annex IV, Article 3 of the IVDD in December 2003. Biomerica completed the translation of all direction inserts into the native languages of each of the countries in Europe where products are distributed. The Company is required to pass an annual audit in order to

maintain the license. We are required to comply with new regulations as they are introduced. Should the Company fail to maintain required licenses, sales could be adversely affected.

SEASONALITY OF BUSINESS

The businesses of the Company and its subsidiaries have not been subject to significant seasonal fluctuations.

INTERNATIONAL BUSINESS

Most of Biomerica's property and equipment are located within southern California. The Company currently has a minor amount of property and equipment located in Mexico. The following table sets forth the dollar volume of revenue attributable to sales to domestic customers and foreign customers during the last two fiscal years for Biomerica and its consolidated subsidiaries:

	Year Ended May 31,	
	2006	2005
U.S. Customers	$2,752,000/38.3%	$3,919,000/41.8%
Asia	405,000/5.6%	259,000/2.8%
Europe	2,678,000/37.3%	3,111,000/33.1%
Middle East	134,000/1.9%	374,000/4.0%
Oceania	582,000/8.1%	686,000/7.3%
S. America	458,000/6.4%	428,000/4.6%
Other foreign	176,000/2.4%	605,000/6.4%
Total Revenues	$7,185,000/100%	$9,382,000/100%

The overall decrease in sales from fiscal 2005 to fiscal 2006 is a result of the deconsolidation of Lancer as of December 1, 2005. On a stand-alone basis, total revenue of Biomerica increased from $3,430,380 to $4,259,954, or $829,574 (24.2%) from 2005 to 2006.

We recognize that our foreign sales could be subject to some special or unusual risks, which are not present in the ordinary course of business in the United States. Changes in economic factors, government regulations, terrorism and import restrictions all could impact sales within certain foreign countries. Foreign countries have licensing requirements applicable to the sale of diagnostic products, which vary substantially from domestic requirements; depending upon the product and the foreign country, these may be more or less restrictive than requirements within the United States. We cannot predict the impact that conversion to the Euro in the European countries may have on Biomerica or Lancer, if any.

Foreign diagnostic sales at Biomerica are made primarily through a network of approximately 100 independent distributors in approximately 60 countries.

INTELLECTUAL PROPERTY

We regard the protection of our copyrights, service marks, trademarks and trade secrets as critical to our future success. We rely on a combination of copyright, trademark, service mark and trade secret laws and contractual

restrictions to establish and protect our proprietary rights in products and services. We have entered into confidentiality and invention assignment agreements with our employees and contractors, and nondisclosure agreements with most of our fulfillment partners and strategic partners to limit access to and disclosure of proprietary information. We cannot be certain that these contractual arrangements or the other steps taken by us to protect our intellectual property will prevent misappropriation of our technology. We have licensed in the past, and expect that we may license in the future, certain of our proprietary rights, such as trademarks or copyrighted material, to third parties. While we attempt to ensure that the quality of our product brands is maintained by such licensees, we cannot be certain that such licensees will not take actions that might hurt the value of our proprietary rights or reputation.

BRANDS, TRADEMARKS, PATENTS

We registered the tradenames "Fortel," "Isletest," "Nimbus" and "GAP" with the Office of Patents and Trademarks on December 31, 1985. Our unregistered tradenames are "EZ-Detect, "Candiquant," "Candigen," "EZ-H.P." and "EZ-PSA." A trademark for "Aware" was issued and assigned in January 2002. Biomerica holds patents on its diagnostic test for Islet Cell Autoantibodies and has co-patent rights to the EZ-Detect Fecal Occult Blood Test (FOBT). In addition, Biomerica holds the following patents: Immunotherapy agents for treatment of IgE mediated allergies, U.S. Patent #5,116,612 issued May 6, 1992; Liposome containing immunotherapy agents for treatment if IgE mediated allergies, U.S. Patent #5,049,390, issued September 17, 1991; Immunotherapy agents for treatment of IgE mediated allergies and Allergen-thymic hormone conjugates for treatment of IgE mediated allergies, U.S. Patent #5,275,814, issued January 4, 1994. Biomerica has obtained the rights to manufacture and sell certain products. In some cases royalties are paid on the sales of these products. Biomerica anticipates that it will license or purchase the rights to other products or technology in the future.

The laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the U.S. Effective copyright, trademark and trade secret protection may not be available in such jurisdictions. Our efforts to protect our intellectual property rights may not prevent misappropriation of our content. In addition, there can be no assurance that Biomerica is not violating any third party patents.

EMPLOYEES

As of July 29, 2006, the Company employed 27 employees of whom 3 are part-time employees in the United States. In fiscal 2005, of the 62 employees, 36 were employees of Lancer and 26 were Biomerica employees. The following is a breakdown between departments:

	2006	2005
Administrative	5	9
Marketing & sales	3	19
Research & development	2	3
Production and operations	17	31
Total	27	62

In addition, Biomerica contracts with Lancer for the services of 21 people at its Mexican facility. We also engage the services of various outside Ph.D. and M.D. consultants as well as medical institutions for technical support on a regular basis. We are not a party to any collective bargaining agreement and have never experienced a work stoppage. We consider our employee relations to be good.

ITEM 2. DESCRIPTION OF PROPERTY

Biomerica leases its primary facility under a non-cancelable operating lease, which expired October 31, 2005, and had an initial monthly lease rate of $15,000 with a 3% increase effective September 1, 2003. The Company is currently operating on a month-to-month agreement while it explores various leasing options. The facilities are owned and operated by four of the Company's shareholders, one of whom is an officer and director. During fiscal 2004 through 2006 the Company consolidated some of its operations and the landlords agreed to take back the space no longer needed by the Company and to reduce the rent accordingly. The landlords also agreed not to institute the 3% increase as required in the lease. Effective May 1, 2006, the monthly rent was set at $14,000 per month. Management believes there would be no significant difference in the terms of the property rental if the Company was renting from a third party. Total gross rent expense for this facility was approximately $158,000 and $148,000 during the years ended May 31, 2006 and 2005, respectively.

The facilities are leased from Mrs. Ilse Sultanian and JSJ Management. Ms. Janet Moore, an officer, director and shareholder of our Company, is a partner in JSJ Management. Mrs. Ilse Sultanian and the other partners of JSJ Management, Susan Irani and Jennifer Irani, are also shareholders of the Company.

Biomerica subleased a portion of its facility under a non-cancelable operating lease, which expired May 16, 2003 and was month-to-month until April 1, 2006, at which time the Company returned that space to the landlord. The Company recorded base rental income of $15,478 and $28,104 during the years ended May 31, 2006 and 2005, respectively.

As of May 31, 2006, we believe that our facilities and equipment are in suitable condition and are adequate to satisfy the current requirements of our Company. However, management is exploring alternative leasing space, which may be more beneficial to the needs of the Company and allow for a more efficient operation at a cost effective rate.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following table summarizes the Company's obligations and commitments as of May 31, 2006:

	Payments Due by Period			
	Total	Less than 1 year	1-3 years	5 years
Shareholder debt	$ 260,942	$ 33,851	$ 227,091	
Operating Leases	15,096	5,328	9,768	
Total	$ 276,038	$ 39,179	$ 236,859	

Biomerica has various small leases for office equipment.

ITEM 3. LEGAL PROCEEDINGS

Inapplicable.

ITEM 4. SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS

Inapplicable.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Since June 20, 2002, the Company's stock has been quoted on the OTC Bulletin Board under the symbol "BMRA.OB". The following table shows the high and low bid prices for Biomerica's common stock for the periods indicated, based upon data reported by Yahoo Finance. Such quotations reflect inter-dealer prices, without retail mark-up, mark-down or commissions, and may not necessarily represent actual transactions.

	Bid Prices	
	High	Low
Quarter ended:		
May 31, 2006	$0.50	$0.40
February 28, 2006	$0.55	$0.46
November 30, 2005	$0.59	$0.42
August 31, 2005	$0.75	$0.47
May 31, 2005	$0.70	$0.42
February 28, 2005	$0.65	$0.38
November 30, 2004	$0.55	$0.40
August 31, 2004	$0.52	$0.35

As of July 19, 2006, the number of holders of record of Biomerica's common stock was approximately 927, excluding stock held in street name. The number of record holders does not bear any relationship to the number of beneficial owners of the Common Stock.

The Company has not paid any cash dividends on its Common Stock in the past and does not plan to pay any cash dividends on its Common Stock in the foreseeable future. The Company's Board of Directors intends, for the foreseeable future, to retain any earnings to finance the continued operation and expansion of the Company's business.

During the past three fiscal years we completed the following private placement transactions exempt under Regulation D of the Securities Act of 1933, as amended:

Date	Title	Amount	Class or Persons Sold To	Price per Share	Total
6/03	common	202,000	insider & qualified investors	$0.25	$ 50,500
5/06	common	156,000	insider & qualified investors	$0.48	$ 74,880

(Of the $74,880 investment in May 2006, $24,960 is classified as common stock subscribed receivable and $49,920 is classified as common stock subscribed in the accompanying financial statements.)

The table below provides information relating to our equity compensation plans as of May 31, 2006:

Securities Plan Category	Number of Securities To be issued upon Exercise of outstanding Options	Compensation Plans Weighted-Average Exercise Price of Outstanding Options	Securitie Remaining Ava for Future Is Under Compens Plans (Exclu Reflected in Column)
Equity compensations Plans approved by Securities holders	1,272,076	$.48	637,969

* Of these shares, 866,000 have not yet been registered by a Form S-8.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS

EXCEPT FOR HISTORICAL INFORMATION CONTAINED HEREIN, THE STATEMENTS IN THIS FORM 10-KSB ARE FORWARD-LOOKING STATEMENTS. FORWARD-LOOKING STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS AND UNCERTAINTIES WHICH MAY CAUSE BIOMERICA'S RESULTS IN FUTURE PERIODS TO DIFFER FROM FORECASTED RESULTS. THESE RISKS AND UNCERTAINTIES INCLUDE, AMONG OTHER THINGS, THE CONTINUED DEMAND FOR THE COMPANYS' PRODUCTS, AVAILABILITY OF RAW MATERIALS AND THE STATE OF THE ECONOMY AND THE CONTINUED ABILITY OF THE COMPANY TO MAINTAIN THE LICENSES AND APPROVALS REQUIRED. THESE AND OTHER RISKS ARE DESCRIBED IN THE COMPANY'S ANNUAL REPORT ON FORM 10-KSB AND IN THE COMPANY'S OTHER FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION.

RESULTS OF OPERATIONS

During the first six months of fiscal 2006 and all of fiscal 2005, Biomerica had one active subsidiary, Lancer Orthodontics, Inc. ("Lancer"), which is engaged in manufacturing, sales and development of orthodontic products. As of May 31, 2005, Biomerica's direct ownership percentage of Lancer was 23.41% and its direct and indirect (via agreements with certain shareholders/directors) voting control over Lancer was greater than 50%. As a result of Biomerica's control and ownership, our financial statements were consolidated with those of Lancer. During the fiscal year ending May 31, 2005, Biomerica was a party to certain informal agreements with certain of Lancer's officers and directors, pursuant to which they agreed to vote in the same manner as Biomerica (and its directors holding shares of Lancer's common stock) on matters requiring the approval of Lancer's stockholders. Biomerica's percentage of direct ownership in Lancer has continued to decrease due to Lancer's issuance of additional shares of its common stock. As of December 1, 2005, the above-mentioned board members reserved their right to no longer vote their shares of Lancer in the same manner as the Biomerica board votes Biomerica's shares of Lancer. Therefore, effective as of December 1, 2005, Lancer's financial statements were no longer consolidated with those of Biomerica because Biomerica no longer has direct or indirect control of more than 50% of Lancer's common stock. As of December 1, 2005, Biomerica held less than 20% of Lancer's common stock and therefore

Biomerica's investment is accounted for under the provisions of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities".

Fiscal 2006 Compared to Fiscal 2005

IN FISCAL 2006, THE LANCER ORTHODONTICS' FINANCIALS WERE ONLY CONSOLIDATED WITH THOSE OF BIOMERICA FOR SIX OF THE TWELVE MONTHS, WHEREAS RESULTS OF OPERATIONS FOR LANCER ORTHODONTICS WERE INCLUDED FOR THE ENTIRE FISCAL YEAR IN FISCAL 2005. PLEASE REFER TO FOOTNOTE 10 FOR A BREAKDOWN BY COMPANY OF THE RESULTS OF OPERATIONS FOR FISCAL 2006 COMPARED TO FISCAL 2005.

Our consolidated net sales were $7,184,992 for fiscal 2006 compared to $9,381,837 for fiscal 2005. This represents a decrease of $2,196,845, or 23.4% for fiscal 2006. The overall decrease in sales from fiscal 2005 to fiscal 2006 is a result of the deconsolidation of Lancer as of December 1, 2005. On a stand-alone basis, the sales of Biomerica increased from $3,430,380 to $4,259,954, or $829,574 (24.2%). Of the total consolidated net sales for fiscal 2006, $2,925,038 is attributable to Lancer (which was for the first six months of the fiscal year), and $4,259,954 to Biomerica. The increase at Biomerica was due to increases of sales to foreign distributors as well as increased sales of certain product lines.

Cost of sales in fiscal 2006 as compared to fiscal 2005 decreased by $1,517,140 or 24.1%. The overall decrease in cost of sales from fiscal 2005 to fiscal 2006 is a result of the deconsolidation of Lancer as of December 1, 2005. On a stand-alone basis, the cost of sales of Biomerica increased from $2,181,001 (63.6% of sales) to $2,604,900 (61.1% of sales), or $423,899 (19.4%). The increase at Biomerica was primarily due to an increase in sales of 24.0%.

Selling, general and administrative costs decreased in fiscal 2006 as compared to fiscal 2005 by $782,095 or 25.7%. The overall decrease in selling, general and administrative costs from fiscal 2005 to fiscal 2006 is a result of the deconsolidation of Lancer as of December 1, 2005. On a stand-alone basis, selling, general and administrative costs of Biomerica increased from $1,001,098 to $1,234,404, or $233,306 (23.3%). The increase at Biomerica was primarily due to higher wages and related costs, accounting and commissions.

Research and development expense decreased in fiscal 2006 as compared to fiscal 2005 by $35,284 or 12.9%. The overall decrease in research and development expense from fiscal 2005 to fiscal 2006 is a result of the deconsolidation of Lancer as of December 1, 2005. On a stand-alone basis, research and development expenses of Biomerica increased from $178,070 to $196,534, or $18,464 (10.4%). The increase at Biomerica was primarily attributable to an outside research contract which was offset by a reclassification of some wages to cost of goods in fiscal 2006.

Interest expense net of interest income, increased in fiscal 2006 as compared to fiscal 2005 by $4,097 or 10.1%. On a stand-alone basis, interest expense net of interest income of Biomerica decreased from $31,596 to $30,334, or $1,262 (4.0%). This was primarily a result of a lower balance on the loan payable. Lancer had increased interest expenses due to higher loan balances.

Other income increased by $9,605 or 26.7% in fiscal 2006 as compared to fiscal 2005. On a stand-alone basis, other income of Biomerica increased from $12,304 to $28,259, or $15,955 (129.7%). This increase was primarily a result of income received in fiscal 2006 for a contract with a customer.

Consolidated net income was $230,273 for the year ended May 31, 2006. Lancer had a net loss of $319,146 (of which $67,476 is Biomerica's share of that loss) for the first six months of the fiscal year, which is included in the fiscal 2006 results. Biomerica had income from continuing operations of $153,765. Prior to recording the expense ($51,896) of employee bonuses according to the Management Incentive Plan, the income from continuing operations was $206,461. Without the Lancer loss, Biomerica would have recognized a gain before discontinued operations and taxes of $222,041. The net income of $230,273 is a result of Biomerica's gain of $222,041 less its percentage of Lancer's loss of $67,476, plus the gain from the discontinued operation of $76,508 and less $800 in income taxes.

As of May 31, 2006 Biomerica had federal and state income tax net operating loss carry forwards of approximately $3,105,000 and $1,013,000, respectively, and research and development tax credit carry forwards of approximately $91,000 and $57,000, respectively. The federal net operating loss carry forwards begin to expire in 2008. The state net operating loss carry forwards expire beginning in 2006. The federal research and development tax credit carry forwards begin to expire in 2009 and the California credits carry forward indefinately.

Liquidity, Capital Resources and Going Concern

As of May 31, 2006, we had cash and current available for sale securities of $123,193 (see Note 2 of Notes to Consolidated Financial Statements) and working capital of $489,948. The Company also has $410,157 of long term available-for-sale securities. During 2006, cash used in operations was $384,369 as compared to cash provided by operations in fiscal 2005 of $72,914. Cash used in operations increased due to funds used to build inventory, as well as higher receivables due to a large sale month in May 2006. During fiscal 2006, cash used in investing activities was $251,743 as compared to $233,352. Both years the cash used in investing activities was primarily for the purchase of property and equipment. Cash provided by financing activities in fiscal 2006 was $538,948 as compared to $159,939 in fiscal 2005. During fiscal 2006 Lancer conducted a private placement which contributed $469,800 to Lancer Orthodontics.

The change in cash and cash equivalents at May 31, 2006 compared to May 31, 2005 on an unconsolidated basis was an increase of $45,193.

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 on September 13, 2003 and was not renewed. The unpaid principal and interest was converted into a note payable bearing interest at 8% and payable September 1, 2004. The due date on this note was extended until September 1, 2005 and subsequently extended until September 1, 2006 at the same terms. Minimum payments of $4,000 per month plus an additional $3,500 per month, depending on quarterly results of the Company, are being made. During August 2006 the due date on the note was extended until September 1, 2007. Although the Company is currently out of compliance with the terms of the loan agreement, the holder of the note payable agreed to extend the due date on the note until September 1, 2007. The terms of the note are the same except that additional payments of $3,500 per month, depending on quarterly results of the Company, have been reduced to $2,000 per month. Of the additional payments of $10,500 per quarter due for the quarters ended August 31, 2005, November 30, 2005 and February 28, 2006, only $5,250 has been paid.

Until two years ago Biomerica had reported substantial recurring losses from operations. Biomerica has funded its operations through profits as well as

debt and equity financings for the past two years. ReadyScript operations were discontinued in May 2001. ReadyScript was a contributor to the Company's losses in prior fiscal years. During the fiscal years ended May 31, 2004 through 2006, certain liabilities were forgiven and thus a discontinued operations profit for the years then ended was recorded. The subsidiary is being reported in the financial statements as a discontinued operation because it is no longer an operating entity.

In the last several years the Company has been focusing on increasing sales and reducing costs where possible and concentrating on its core business to increase sales. As a stand-alone company, Biomerica has recorded operationing profits for the past two fiscal years. Management believes that cash flows from current operations are sufficient to enable the Company to fund operations for at least the next twelve months. Should the Company have a downturn in sales or unanticipated, increased expenses, the result for the Company could be the inability to continue as a going concern. The Company will continue to have limited cash resources. Biomerica has no open or existing, operating line of credit or loans on which it can draw any new or additional debt financing, however the Company is currently investigating the possibility of obtaining a line of credit from a bank

Our independent registered public accounting firm has concluded that there is 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 report 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.

During 2004 and 2003, a shareholder advanced the Company $4,000 and $10,000, respectively. During June 2003 the $10,000 advance was repaid in the form of Company common stock at the price of $.25 per share. At May 31, 2006, $1,659 was owed in interest payable on the two loans.

During 2006 and 2005, the Company incurred $22,355 and $25,017, respectively, in interest expense related to the shareholder line of credit, note payable and rental liabilities. As of May 31, 2006, $0 in accrued interest was due on the promissory note and rental liabilities.

SUBSEQUENT EVENTS

In July 2006 a one year distribution agreement was entered into with Grifols USA, LLC wherein Grifols was appointed as a non-exclusive distributor in the United States for certain of the Company's products.

During August 2006 the due date on the note payable was extended until September 1, 2007. The terms of the note payable are the same except for additional payments of $3,500 per month, depending on quarterly results of the Company, have been reduced to $2,000 per month.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial condition and results of operations are based on the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the

United States. Note 2 of the Notes to Consolidated Financial Statements describes the significant accounting policies essential to the consolidated financial statements. The preparation of these 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 Allowance for Doubtful Accounts, Inventory Reserves for Obsolescence and Declines in Market Value, Impairment of Long-Lived Assets, Stock Based Compensation, and Income Tax Accruals.

Revenues from product sales are recognized at the time the product is shipped, customarily FOB shipping point, at which point title passes. An allowance is established if necessary for estimated returns as revenue is recognized.

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 probable and have established specific reserves, but to the extent collection is made, the allowance will be released. Additionally, if the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. For one international customer, the Company has obtained an insurance policy which insures against non-collection up to the amount of $90,000.

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.

Historically we have been 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 May 31, 2006, 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.

FACTORS THAT MAY AFFECT FUTURE RESULTS

You should read the following factors in conjunction with the factors

discussed elsewhere in this and our other filings with the SEC and in materials incorporated by reference in these filings. The following is intended to highlight certain factors that may affect the financial condition and results of operations of Biomerica, Inc. and are not meant to be an exhaustive discussion of risks that apply to companies such as Biomerica, Inc. Like other businesses, Biomerica, Inc. is susceptible to macroeconomic downturns in the United States or abroad, as were experienced in fiscal year 2002, that may affect the general economic climate and performance of Biomerica, Inc. 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 out 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 operations as a whole; failure to manage the future expansion of our business could have a material 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, some 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 these factors make it difficult to predict operating results for any particular period.

INSURANCE COVERAGE

Biomerica currently carries various insurance policies including products liability ($2,000,000), general liability ($2,000,000), property insurance (personal property-$1,754,788), business income insurance ($800,000), employee benefit errors or omissions liability insurance ($1,000,000), commercial crime insurance ($100,000), crime insurance (pension plan) ($300,000), employee theft ($100,000), depositor's forgery ($100,000), commercial auto ($1,000,000), umbrella liability insurance ($1,000,000), workman's compensation insurance ($1,000,000), directors and officers' insurance ($3,000,000), group health, disability and life insurance The Company also has an export credit insurance policy with a coverage limit of $90,000 to insure against loss from one of its major international customers which allows for them to carry a higher receivable balance than the Company would normally allow. Biomerica's workman's compensation policies covers injuries to employees as a result of accidental contamination of hazardous materials. The companies do not have a separate policy for contamination of hazardous materials.

RECENT ACCOUNTING PRONOUNCEMENTS:

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R). SFAS No. 123R revised SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123R will require compensation costs related to share-based payment transactions to be recognized in the financial statement (with limited exceptions). The amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. Compensation cost will be recognized over the period that an employee provides

service in exchange for the award.

In March 2005, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 107 ("SAB No. 107"), Share-Based Payment, providing guidance on option valuation methods, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123R, and the disclosures in MD&A subsequent to the adoption. The Company will provide SAB No. 107 required disclosures upon adoption of SFAS No. 123R on June 1, 2006 and is currently evaluating the impact the adoption of the standard will have on the Company's financial condition, results of operations, and cash flows.

In April 2005, the Securities and Exchange Commission adopted a new rule that amends the compliance dates for SFAS No. 123R. The Statement requires that compensation cost relating to share-based payment transactions be recognized in financial statements and that this cost be measured based on the fair value of the equity or liability instruments issued. SFAS No. 123R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The Company adopted SFAS No. 123R on June 1, 2006.

In June 2005, the FASB issued SFAS No. 154, Accounting Changes and Errors Corrections, a replacement of APB Opinion No. 20 and SFAS No. 3. The Statement applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impractical. APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS No.154 improves the financial reporting because its requirements enhance the consistency of financial reporting between periods. The Company does not believe the adoption of this standard will have an impact on its results of operations.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140 ("SFAS, 155"). This statement resolves issues addressed in SFAS No. 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interest in Securitized Financial Assets. SFAS No. 155: a) permits fair value remeasurement for any hybrid financial instrument that contains an imbedded derivative that otherwise would require bifurcation; (b) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133; (c) establishes a requirement to evaluate beneficial interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an imbedded derivative requiring bifurcation; (d) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and, (e) eliminates restriction on a qualifying special-purpose entity's ability to hold passive derivative financial instruments that pertain to beneficial interests that are or contain a derivative financial instrument. SFAS No. 155 also requires presentation within the financial statements that identifies those hybrid financial instruments for which the fair value election has been applied and information on the income statement impact of the changes in fair value of those instruments. The Company is required to apply SFAS No. 155 to all financial instruments acquired, issued or subject to a remeasurement

event beginning June 1, 2007. The Company does not expect the adoption of SFAS No. 155 to have a material impact on the Company's financial statements.

ITEM 7. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Exhibit 99.3, "Biomerica, Inc. and Subsidiaries Consolidated Financial Statements" is incorporated herein by this reference.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Inapplicable.

ITEM 8A. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934 reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Principal Executive Officer and our Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Our management, including our Principal Executive Officer and our Principal Financial Officer, does not expect that our disclosure controls or procedures will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Biomerica have been detected.

We carried out an evaluation, under the supervision and with the participation of our management, including our Principal Executive Officer and our Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the annual period covered by this report. Based on the foregoing, our Principal Executive Officer and our Principal Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in the Company's internal controls over financial reporting during the Company's most recent fiscal year that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCEWITH SECTION 16(A) OF THE EXCHANGE ACT.

This information is incorporated by reference to the Company's proxy statement for its 2006 Annual Meeting of Stockholders, which will be filed not later than 120 days after the end of the Company's fiscal year ended May 31, 2006.

ITEM 10. EXECUTIVE COMPENSATION

This information is incorporated by reference to the Company's proxy statement for its 2006 Annual Meeting of Stockholders, which will be filed not later than 120 days after the end of the Company's fiscal year ended May 31, 2006.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

This information is incorporated by reference to the Company's proxy statement for its 2006 Annual Meeting of Stockholders, which will be filed not later than 120 days after the end of the Company's fiscal year ended May 31, 2006.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In fiscal 2003, Biomerica entered into an agreement with Lancer whereby Biomerica agreed to pay an initial shelter fee of $5,000 with additional monthly payments of $2,875 for use of the Lancer de Mexico facilities to produce and manufacture Biomerica products. The monthly payments are due as long as Biomerica produces its products at the Lancer de Mexico facility. At May 31, 2006, Biomerica has paid all applicable shelter fees.

Other information regarding related transactions is incorporated by reference to the Company's proxy statement for its 2006 Annual Meeting of Stockholders, which will be filed not later than 120 days after the end of the Company's fiscal year ended May 31, 2006.

ITEM 13. EXHIBITS LIST AND REPORTS ON FORM 8-K

EXHIBIT NO.	DESCRIPTION
3.1	Certificate of Incorporation of Registrant filed with the Secretary of the State of Delaware on September 22, 1971 (incorporated by reference to Exhibit 3.1 filed with Amendment No. 1 to Registration Statement on Form S-1, Commission File No. 2-83308).
3.2	Certificate of Amendment to Certificate of Incorporation of Registrant filed with the Secretary of the State of Delaware on February 6, 1978 (incorporated by reference to Exhibit 3.1 filed with Amendment No. 1 to Registration Statement on Form S-1, Commission File No. 2-83308).
3.3	Certificate of Amendment to Certificate of Incorporation of Registrant filed with the Secretary of the State of Delaware on February 4, 1983 (incorporated by reference to Exhibit 3.1 filed with Amendment No. 1 to Registration Statement on Form S-1, Commission File No. 2-83308).
3.4	Certificate of Amendment to Certificate of Incorporation of Registrant filed with the Secretary of the State of Delaware on January 19, 1987 (incorporated by reference to Exhibit 3.4 filed with Form 8 Amendment No. 1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended May 31, 1987).

3.5	Certificate of Amendment of Certificate of Incorporation of Registrant filed with the Secretary of the State of Delaware on November 4, 1987 (incorporated by reference to Exhibit 3.1 filed with Amendment No. 1 to Registration Statement on Form S-1, Commission File No. 2-83308).
3.6	Bylaws of the Registrant (incorporated by reference to Exhibit 3.2 filed with Amendment No. 1 to Registration Statement on Form S-1, Commission File No. 2-83308).
3.7	Certificate of Amendment of Certificate of Incorporation of Registrant filed with the Secretary of the State of Delaware on December 20, 1994 (incorporated by reference to Exhibit 3.7 filed with Registrant's Annual Report on Form 10-KSB for the fiscal year ended May 31, 1995).
3.8	First Amended and Restated Certificate of Incorporation of Biomerica, Inc. filed with the Secretary of State of Delaware on August 1, 2000 (incorporated by reference to Exhibit 3.8 filed with the Registrant's Annual Report on Form 10-KSB for the fiscal year ended May 31, 2000).
4.1	Specimen Stock Certificate of Common Stock of Registrant (incorporated by reference to Exhibit 4.1 filed with Registrant's Registration Statement on Form SB-2, Commission No. 333-87231 filed on September 16, 1999).
10.3	1999 Stock Incentive Plan of Registrant (incorporated by reference to Exhibit 10.1 to Registration Statement on Form S-8 filed with the Securities and Exchange Commission on March 29, 2000).
10.4	1995 Stock Option and Common Stock Plan of Registrant (incorporated by reference to Exhibit 4.3 to Registration Statement on Form S-8 filed with the Securities and Exchange Commission on January 20, 1996).
10.5	1991 Stock Option and Restricted Stock Plan of Registrant (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 filed with the Securities and Exchange Commission on April 6, 1992).
10.31	Loan Modification, Forbearance and Security Agreement (incorporated by reference to the Company's February 29, 2004 Form 10-QSB filed April 14, 2004).
10.32	Promissory Note (incorporated by reference to the Company's February 29, 2004 Form 10-QSB filed April 14, 2004).
21.1	Subsidiaries of Registrant.
23.2	Consent of Independent Registered Public Accounting Firm (PKF San Diego).

31.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of

	the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.3	Biomerica, Inc. and Subsidiaries Consolidated Financial Statements For The Years Ended May 31, 2006 and 2005 and Independent Registered Public Accounting Firm's Report.

(b) Reports on Form 8-K.

None.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The aggregate fees billed for professional services by PKF (San Diego) in 2006 and 2005 were as follows:

	2006	2005
Audit fees	$ 48,725(1)	$78,190 (2)
Audit related fees	--	1,208
Tax fees	5,219	6,197
All other fees	2,711	--
total	$ 56,655	$85,595

(1) Includes $34,000 billed in fiscal 2007.
(2) Includes $59,000 billed in fiscal 2006.

Audit Fees consist of the aggregate fees billed for professional services rendered for the audit of our annual financial statements, the audit of our subsidiaries financial statements, the reviews of the financial statements included in our Forms 10-QSB, the reviews of the financial statement included in our subsidiaries Form 10-QSB and for any other services that are normally provided by PKF in connection with our statutory and regulatory filings or engagements.

Audit Related Fees consist of the aggregate fees billed for professional services rendered for assurance and related services that were reasonably related to the performance of the audit or review of our financial statements and the financial statements of our subsidiaries that were not otherwise included in Audit Fees.

Tax Fees consist of the aggregate fees billed for professional services rendered for tax compliance, tax advice and tax planning. Included in such Tax Fees were

fees for preparation of our tax returns and consultancy and advice on other tax planning matters.

All Other Fees consist of the aggregate fees billed for products and services provided by PKF and not otherwise included in Audit Fees, Audit Related fees or Tax Fees.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BIOMERICA, INC.
Registrant

By /s/ Zackary S. Irani

Zackary S. Irani, Chief Executive Officer

Dated: 8/29/06

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature and Capacity

/s/ Zackary S. Irani — Date: 8/29/06

Zackary S. Irani
Director, Chief Executive Officer

/s/ Janet Moore — Date: 8/29/06

Janet Moore,
Secretary, Director,
Chief Financial Officer

/s/ Francis R. Cano — Date: 8/29/06

Francis R. Cano
Director

/s/ Allen Barbieri — Date: 8/29/06

Allen Barbieri
Director

BIOMERICA, INC. AND SUBSIDIARIES
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Biomerica, Inc.
Newport Beach, California

We have audited the accompanying consolidated balance sheet of Biomerica, Inc. (a Delaware Corporation) and its subsidiaries as of May 31, 2006 and the related consolidated statements of operations and comprehensive income, shareholders' equity, and cash flows for the years ended May 31, 2006 and 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We have conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Biomerica, Inc. as of May 31, 2006, and the results of its consolidated operations and cash flows for the years ended May 31, 2006 and 2005 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company has historically reported net losses and negative cash flows from operations, which raises liquidity concerns. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management estimates that its available cash resources as of May 31, 2006 and, anticipated increased sales and financing

activities should be sufficient to fund planned operations through May 31, 2007. Management's plans in regard to these matters are described in Note 1 to the accompanying consolidated financial statements. 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 from the outcome of this uncertainty.

August 11, 2006
San Diego California

/s/ PKF
Certified Public Accountants
A Professional Corporation

BIOMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

MAY 31,	2006
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 119,914
Available-for-sale securities	3,279
Accounts receivable, less allowance for doubtful accounts of $7,030	560,721
Inventories, net	1,104,367
Prepaid expenses and other	57,668
Total current assets	1,845,949
INVENTORIES, non-current	23,663
PROPERTY AND EQUIPMENT, at cost	
Equipment	597,795
Furniture, fixtures and leasehold improvements	159,074
	756,869
ACCUMULATED DEPRECIATION	(629,478)
Net property and equipment	127,391
INTANGIBLE ASSETS, net	7,763
AVAILABLE-FOR-SALE SECURITIES	410,137
OTHER ASSETS	13,419
	$ 2,428,322
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES	

Accounts payable and accrued expenses	$ 580,767
Accrued compensation	483,308
Capital lease - short-term portion	3,714
Notes payable-shareholder	260,942
Net liabilities from discontinued operations	27,270
Total current liabilities	1,356,001
Capital lease - long-term portion	8,574
SHAREHOLDERS' EQUITY	
Common stock, $.08 par value; 25,000,000 shares authorized; 5,922,681 shares subscribed and issued and outstanding	461,333
Additional paid in capital	17,064,324
Common stock subscribed	74,880
Common stock subscribed receivable	(24,960)
Accumulated other comprehensive income	(226,971)
Accumulated deficit	(16,284,859)
Total shareholders' equity	1,063,747
	$ 2,428,322

See report of independent registered public accounting firm and accompanying notes to consolidated financial statements.

BIOMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

Note: Due to the deconsolidation of Lancer as of December 1, 2005, consolidated results from fisc include only the first two quarters of the results of operations of Lancer, whereas consolidated fiscal 2005 include a full year of results of operations of Lancer.

YEARS ENDED MAY 31,	2006
NET SALES	$ 7,184,992
Cost of sales	4,779,615
GROSS PROFIT	2,405,377
OPERATING EXPENSES	
Selling, general and administrative	2,263,463
Research and development	239,004
Total operating expenses	2,502,467
OPERATING LOSS FROM CONTINUING OPERATIONS	(97,090)
OTHER INCOME (EXPENSE)	

Interest expense, net of interest income	(44,790)
Other income, net	45,575
INCOME (LOSS) FROM CONTINUING OPERATIONS, before minority interest in net loss of consolidated subsidiaries and income taxes	(96,305)
MINORITY INTEREST IN NET LOSS OF CONSOLIDATED SUBSIDIARIES	251,670
INCOME (LOSS) FROM CONTINUING OPERATIONS, before income taxes	155,365
INCOME TAX EXPENSE	1,600
INCOME (LOSS) FROM CONTINUING OPERATIONS	153,765
DISCONTINUED OPERATIONS	
Income from discontinued operations, net	76,508
NET INCOME	230,273

BIOMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (CONTINUED)

YEARS ENDED MAY 31,	2006
OTHER COMPREHENSIVE INCOME (LOSS), net of tax	
Unrealized income (loss) on available-for-sale securities	(227,496)
COMPREHENSIVE INCOME	$ 2,777
BASIC NET INCOME (LOSS) PER COMMON SHARE:	
Income (loss) from continuing operations	$ .03
Income from discontinued operations	.01
Basic net income per common share	$ .04
DILUTED NET INCOME (LOSS) PER COMMON SHARE:	
Income (Loss) from continuing operations	$ .02
Income from discontinued operations	.01
Diluted net income (loss) per common share	$ .03
WEIGHTED AVERAGE NUMBER OF COMMON AND COMMON EQUIVALENT SHARES	
Basic	5,759,082
Diluted	6,220,335

See report of independent registered public accounting firm and accompanying

notes to consolidated financial statements.

BIOMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Sha
Balances, May 31, 2004	5,752,431	$ 460,193	$ 17,125,005	-
Private placement	--	--	--	-
Change in unrealized gain (loss) on available-for-sale securities	--	--	--	-
Compensation expense in connection with options and warrants granted	--	--	3,563	-
Expense related to issuance of warrants for extension of note	--	--	10,400	-
Change in minority interest related to sale of stock at subsidiary	--	--	(31,494)	-
Net income	--	--	--	-
Balances, May 31, 2005	5,752,431	$ 460,193	$ 17,107,474	-

(Continued)

	Accumulated Other Comprehensive Income (Loss)	Accumul Defic
Balances, May 31, 2004	$ 18,466	$(16,677
Change in unrealized gain (loss) on available-for-sale securities	(17,940)	
Compensation expense in connection with options and warrants granted	--	
Expense related to issuance of warrants for extension of note	--	

Change in minority interest related to sale of stock at subsidiary to sale of stock at subsidiary	--	
Net loss	--	162
Balances, May 31, 2005	526	$(16,515

(Continued)

BIOMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY - CONTINUED

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital
Change in unrealized gain (loss) on available-for-sale securities	--	--	--
Exercise of stock options	14,250	1,140	2,295
Change in Lancer stock to unrealized gain on available-for-sale securities	--	--	--
Compensation expense in connection with options and warrants granted	--	--	2,444
Expense related to issuance of warrants for private placement	--	--	9,880
Private Placement	--	--	--
Private Placement - receivable	--	--	--
Change in minority interest related to sale of stock at subsidiary	--	--	(57,769)
Net income	--	--	--
Balances, May 31, 2006	5,766,681	$ 461,333	$ 17,064,324

Common Stock	Accumulated Other Comprehensive

	Subscribed Receivable	Income (Loss)	Accumulated Deficit
Change in unrealized gain (loss) on available-for-sale securities	--	(4,901)	--
Exercise of stock options	--	--	--
Change in Lancer stock to unrealized gain on available-for-sale securities	--	(222,596)	--
Compensation expense in connection with options and warrants granted	--	--	--
Expense related to issuance of warrants for private placement	--	--	--
Private placement	--	--	--
Private placement - receivable	(24,960)	--	--
Change in minority interest related to sale of stock at subsidiary	--	--	--
Net income	--	--	230,273
Balances, May 31, 2006	$ (24,960)	$ (226,971)	$(16,284,859)

See report of independent registered public accounting firm and accompanying notes to consolidated financial statements.

BIOMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED MAY 31,	2006	200
CASH FLOWS FROM OPERATING ACTIVITIES		
Income from continuing operations	$ 153,765	$ (21,
Adjustments to reconcile loss from continuing operations to net cash (used in) provided by operating activities:		
Depreciation and amortization	122,047	159,
Provision for gain (losses) on accounts receivable	12,372	(3,
Provision for losses on inventory	(3,687)	(40,
Gain on sales of available for sale securities	(685)	(8,
Warrants and options issued	12,324	3,
Common stock issued or subscribed for services rendered for the consolidated subsidiaries	--	79,
Warrants issued for extension of note	--	10,
Minority interest in net (loss) of consolidated subsidiaries	(251,670)	(219,
Loss on disposal of property and equipment	1,704	1,
Changes in assets and liabilities		
Accounts receivable	(441,385)	(201,

Inventories	(261,864)	32,
Prepaid expenses and other	(33,701)	67,
Other receivables and assets	--	(13,
Accounts payable and other accrued expenses	243,787	100,
Accrued compensation	62,624	128,
Net cash (used in) provided by operating activities	(384,369)	72,
CASH FLOWS FROM INVESTING ACTIVITIES		
Sales of available-for-sale securities	685	8,
Purchases of property and equipment	(252,428)	(242,
Net cash (used in) investing activities	(251,743)	(233,

(Continued)

BIOMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

FOR THE YEARS ENDED MAY 31,	2006
CASH FLOWS FROM FINANCING ACTIVITIES	
Net increase under line of credit at subsidiary	65,000
Payments on capital leases	(26,352)
Private placement at subsidiary	
Decrease of shareholder debt	(40,145)
Change in minority interests	37,250
Exercise of stock options	3,435
Exercise of stock option at subsidiary	--
Sale of common stock, net of offering expenses	29,960
Consolidated subsidiaries sale of common stock	469,800
Net cash provided by financing activities	538,948
Net cash provided by (used in) discontinued operations	(800)
Net change in cash and cash equivalents	(97,964)
Net decrease in cash-reclassification of Lancer Orthodontics, Inc. to the cost method	(134,003)
CASH AND CASH EQUIVALENTS, beginning of year	351,881
CASH AND CASH EQUIVALENTS, end of year	$ 119,914
SUPPLEMENTAL DISCLOSURE OF CASH-FLOW INFORMATION	

CASH PAID DURING THE YEAR FOR:	
Interest	$ 44,790
Income taxes	$ 1,600
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES	
Change in unrealized holding gain (loss) on available-for-sale securities	$ (227,496)
Change in minority interest due to subsidiary sale of stock	$ (57,769)
Capital lease for purchase of fixed assets	$ (373,435)
Increase in investment due to de-consolidation of Lancer	$ 632,732
Reduction of accrued compensation through purchase of stock	$ 19,960
Subscribed stock receivable	$ 24,960

Changes due to de-consolidation of Lancer

Accounts Receivable	$ 1,590,504
Inventories	1,838,698
Prepaid expenses and other current assets	90,676
Net fixed assets	1,197,310
Other	48,821
Subtotal assets	4,766,009
Accounts payable and other accrued liabilities	899,483
Line of credit	240,000
Capital lease	334,794
Subscribed stock	85,850
Common stock	5,670,565
Accumulated deficit	(2,330,680)
Subtotal liabilities and equity	(4,900,012)
Net decrease in cash	$ (134,003)

See report of independent registered public accounting firm and accompanying notes to consolidated financial statements.

BIOMERICA, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MAY 31, 2006 AND 2005

1. ORGANIZATION AND LIQUIDITY

ORGANIZATION

Biomerica, Inc. and Subsidiaries (collectively "the Company") are primarily engaged in the development, manufacture and marketing medical diagnostic kits

and the design, manufacture and distribution of various orthodontic products.

LIQUIDITY AND 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 losses and negative cash flows from operations. Biomerica's shareholder's line of credit (Note 5) expired on September 13, 2003 and was not renewed. The unpaid principal and interest was converted into a note payable bearing interest at 8% and payable September 1, 2004. The due date on this note was extended until September 1, 2005 and subsequently was extended until September 1, 2006 at the same terms (Note 12). Minimum payments of $4,000 per month plus an additional $3,500 per month, depending on quarterly results of the Company, are being made. Although the Company is currently out of compliance with the terms of the loan agreement, the note holder agreed to extend the due date on the note payable until September 1, 2007. The terms of the note payable are the same except that additional payments of $3,500 per month, depending on quarterly results of the Company, have been reduced to $2,000 per month. Of the additional payments of $10,500 per quarter due for the quarters ended August 31, 2005, November 30, 2005 and February 28, 2006, only $5,250 has been paid.

Until two years ago Biomerica had reported substantial recurring losses from operations. Biomerica has funded its operations through profits, debt and equity financings for the past two years. ReadyScript operations were discontinued in May 2001 (see Notes 3 and 11). ReadyScript was a contributor to the Company's losses in prior fiscal years. During the fiscal years ended May 31, 2004 through 2006, certain ReadyScript liabilities were forgiven and thus income from discontinued operations for the years then ended was recorded. The subsidiary is being reported in the financial statements as a discontinued operation because it is no longer an operating entity.

In the last several years the Company has been focusing on reducing costs where possible and concentrating on its core business to increase sales. Management believes that cash flows from current operations are sufficient to fund operations for at least the next twelve months. Should the Company have a downturn in sales or unanticipated, increased expenses, the result for the Company could be the inability to continue as a going concern. The Company will continue to have limited cash resources. Biomerica, as a parent entity, has no open or existing, operating line of credit or loans on which it can draw any new or additional debt financing, however, management is currently investigating obtaining a line of credit from a bank.

Our independent registered public accounting firm has concluded that there is 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 report 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements for the years ended May 31, 2006 and 2005 (see Note 3) include the accounts of Biomerica, Inc. ("Biomerica"), Lancer Orthodontics, Inc. ("Lancer") (for the first six months of the 2006 fiscal year) and ReadyScript, Inc. (as discontinued operations). All significant intercompany accounts and transactions have been eliminated in consolidation. Effective December 1, 2005 the operations of Lancer Orthodontics were no longer

consolidated with those of Biomerica. The consolidated statement of operations for the year ended May 31, 2006 includes the results of Lancer Orthodontics for the period of June 1, 2005 through November 30, 2005. The balance sheet as of May 31, 2006 does not include any assets or liabilities of Lancer Orthodontics (other than the available-for-sale securities of Lancer which Biomerica holds as an investment).

ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Actual results could materially differ from those estimates.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company has financial instruments whereby the fair market value of the financial instruments could be different than that recorded on a historical basis. The Company's financial instruments consist of its cash and cash equivalents, accounts receivable, available-for-sale securities, capital lease, shareholder debt and accounts payable. The carrying amounts of the Company's financial instruments approximate their fair values at May 31, 2006.

Most of the Company's available-for-sale securities include the Company's investment in Lancer Orthodontics in the amount of $410,137. The Company also has current available-for-sale securities in the amount of $3,279. The ability to sell these shares on the open market could be affected by market conditions, Lancer's financial reports, and the trading volume of Lancer's shares, among other factors.

CONCENTRATION OF CREDIT RISK

The Company, on occasion, maintains cash balances at certain financial institutions in excess of amounts insured by federal agencies.

The Company provides credit in the normal course of business to customers throughout the United States and foreign markets. The Company's sales are not materially dependent on a single customer or a small group of customers, however, on an unconsolidated basis Biomerica had two customers each of whom accounted for greater than 10% of its sales for the fiscal years ended May 31, 2006 and 2005. The Company performs ongoing credit evaluations of its customers. The Company does not obtain collateral with which to secure its accounts receivable, however the Company obtained an insurance policy in the amount of $90,000 to insure against loss of non-collection for one of the Company's major international customers. The Company maintains reserves for potential credit losses based upon the Company's historical experience related to credit losses. At May 31, 2006 three customers each accounted for greater than 10% of gross accounts receivable for Biomerica. At May 31, 2005 no customer accounted for

more than 10% of gross consolidated accounts receivable.

On a consolidated basis no customer accounted for 10% or more of the consolidated sales in the fiscal years ended May 31, 2006 and 2005. No customer accounted for 10% or more of Lancer Orthodontics' sales for the fiscal year ended May 31 2005.

For the year ended May 31, 2006 one company accounted for more than 10% of the purchases for Biomerica on an unconsolidated basis and for the fiscal year ended May 31, 2005 two companies accounted for more than 10% of the purchases for Biomerica on an unconsolidated basis.

In July 2005, Lancer signed a large contract manufacturing agreement with an orthodontic reseller, wherein the reseller committed to purchase at least $960,000 of product from Lancer during the period of July 1, 2005 to October 1, 2006.

GEOGRAPHIC CONCENTRATION

Approximately $154,000 of Biomerica's gross inventory and $12,000 of Biomerica's property and equipment, net of accumulated depreciation and amortization, is located at Lancer's wholly owned subsidiary in Mexico.

CASH EQUIVALENTS

Cash and cash equivalents consist of demand deposits and money market accounts.

AVAILABLE-FOR-SALE SECURITIES

The Company accounts for investments in accordance with Statement of Financial Accounting Standards No. 115 (SFAS 115), "ACCOUNTING FOR CERTAIN INVESTMENTS IN DEBT AND EQUITY SECURITIES." This statement addresses the accounting and reporting for investments in equity securities which have readily determinable fair values and all investments in debt securities. The Company's marketable equity securities are classified as available-for-sale under SFAS 115 and reported at fair value, with changes in the unrealized holding gain or loss included in shareholders' equity. Available-for-sale securities consist of common stock of publicly-traded companies and are stated at market value in accordance with SFAS 115. Cost for purposes of computing realized gains and losses is computed on a specific identification basis. The proceeds from the sale of available-for-sale securities during fiscal 2006 was $685 and for 2005 totaled $8,888. The change in the net unrealized holding gain (loss) on available-for-sale securities that has been included as a separate component of shareholders' equity totaled $(227,496) and $(17,940) for the years ended May 31, 2006 and 2005, respectively. The decrease in fiscal 2006 was primarily a result of a write down of $222,596 to market value of the Lancer securities that the Company previously classified as an investment under the equity method of accounting. See Principles of Consolidation above.

The Company has a total of $413,416 in available-for-sale securities of which $410,137 is its long-term investment in Lancer Orthodontics common stock. As

described earlier, effective December 1, 2005, the financial results of the former subsidiary, Lancer Orthodontics, were no longer consolidated with those of Biomerica. At that time the investment amount carried on the Biomerica balance sheet for Biomerica's ownership in Lancer was $632,733, or approximately $.93 per share. Due to the change in status from subsidiary to available-for-sale security, the Company adopted the accounting provisions of SFAS 115 for this investment. This resulted in a write-down to quoted market value with losses recognized in other comprehensive income. On May 31, 2006 the closing price for Lancer common stock was $.60 per share which is equal to a total investment of $410,137. Management evaluated various factors with respect to its investment in Lancer, including advances and changes within the industry, strategic relationships with other manufacturers, and the Company's ability and intent to hold this investment for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider this investment decline to be other-than-temporary as of May 31, 2006.

INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out method) or market and consist primarily of biological chemicals. Cost includes raw materials, labor, manufacturing overhead and purchased products. Market is determined by comparison with recent purchases or net realizable value. Such net realizable value is based on forecasts for sales of the Company's products in the ensuing years. Non-current inventories represent inventories on hand in excess of amounts expected to be utilized over the next twelve months. The industry in which the Company operates is characterized by technological advancement and change. Should demand for the Company's products prove to be significantly less than anticipated, the ultimate realizable value of the Company's inventories could be substantially less than the amount shown on the accompanying consolidated balance sheet.

Inventories approximate the following:

MAY 31,	2006
Raw materials	$ 416,423
Work in progress	331,377
Finished products	359,461
Inventory reserve	(2,894)
Current Portion	1,104,367
Long-term Portion	$ 23,663
Total	$ 1,128,030

Approximately $154,000 of Biomerica's gross inventory is located at its manufacturing facility in Mexico as of May 31, 2006.

Allowances for inventory obsolescence are recorded as necessary to reduce obsolete inventory to estimated net realizable value or to specifically reserve for obsolete inventory that the Company intends to dispose of. The inventory items identified for disposal at each year-end are generally discarded during the following year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MAY 31, 2006 AND 2005

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Expenditures for additions and major improvements are capitalized. Repairs and maintenance costs are charged to operations as incurred. When property and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation or amortization are removed from the accounts, and gains or losses from retirements and dispositions are credited or charged to income.

Depreciation and amortization are provided over the estimated useful lives of the related assets, ranging from 3 to 10 years, using the straight-line method. Leasehold improvements are amortized over the lesser of the estimated useful life of the asset or the term of the lease. Depreciation and amortization expense amounted to $122,047 and $159,317 for the years ended May 31, 2006 and 2005, respectively. At May 31, 2006, approximately $12,000 of Biomerica's property and equipment, net of accumulated depreciation and amortization, is located at Lancer's manufacturing facility in Mexico.

Management of the Company assesses the recoverability of property and equipment by determining whether the depreciation and amortization of such assets over their remaining lives can be recovered through projected undiscounted cash flows. The amount of impairment, if any, is measured based on fair value (projected discounted cash flows) and is charged to operations in the period in which such impairment is determined by management. Management has determined that there is no impairment of property and equipment at May 31, 2006.

In August and September 2005 Lancer entered into three equipment finance leases for the purchase of manufacturing equipment for the Lingualcare project. The lease payments began in September and October 2005 and have a total of $424,574 due and minimum payments per month of $8,845. The term of the leases is forty-eight months. These agreements have varying financing terms. Biomerica has no financial responsibility with respect to these leases and as of fiscal year-end they are no longer being reported as liabilities on Biomerica's consolidated balance sheet as a result of the de-consolidation of Lancer.

INTANGIBLE ASSETS

On June 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142 ("SFAS No. 142"), "Goodwill and Other Intangible Assets." SFAS No. 142 requires that the Company's license agreements be tested annually (or more frequently if impairment indicators arise) for impairment. Upon initial application of SFAS No. 142, the Company determined there was no impairment. The Company has established the date of May 31 on which to conduct its annual impairment test.

Intangible assets are being amortized using the straight-line method over the useful life, not to exceed 18 years for marketing and distribution rights and purchased technology use rights, and 17 years for patents. Amortization amounted to $5,175 and $18,951 for the years ended May 31, 2006 and 2005, respectively (see Note 4). Stand-alone amounts for Biomerica amounted to $5,175 and $8,576 for fiscal 2006 and 2005, respectively.

BIOMERICA, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MAY 31, 2006 AND 2005

The Company assesses the recoverability of these intangible assets by determining whether the amortization of the asset's balance over its remaining life can be recovered through projected undiscounted future cash flows. The amount of impairment, if any, is measured based on fair value and charged to operations in the period in which the impairment is determined by management.

RISKS AND UNCERTAINTIES

Biomerica has entered into a royalty agreement which continues pursuant to which it has obtained rights to manufacture and market certain products for the life of the products. Royalty expense of approximately $101,600 and $79,000 is included in cost of sales for this agreement for the years ended May 31, 2006 and 2005, respectively. Sales of products manufactured under this agreement comprise approximately 5% and 4% of total sales for the fiscal years ended May 31, 2006 and 2005, respectively. Biomerica may license other products or technology in the future as the Company deems necessary for conducting business.

Distribution - Biomerica 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. Biomerica 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 Regulation - Biomerica's immunodiagnostic products are regulated in the United States as medical devices primarily by the FDA and as such, require regulatory clearance or approval prior to commercialization in the United States. Pursuant to the Federal Food, Drug and Cosmetic Act, and the regulations promulgated thereunder, the FDA regulates, among other things, the clinical testing, manufacture, labeling, promotion, distribution, sale and use of medical devices in the United States. Failure of Biomerica to comply with applicable regulatory requirements can result in, among other things, warning letters, fines, injunctions, civil penalties, recall or seizure of products, total or partial suspension of production, the government's refusal to grant premarket clearance or premarket approval of devices, withdrawal of marketing approvals, and criminal prosecution.

Sales of medical devices outside the United States are subject to foreign regulatory requirements that vary widely from country to country. The time required to obtain registrations or approvals required by foreign countries may be longer or shorter than that required for FDA clearance or approval, and requirements for licensing may differ significantly from FDA requirements. There can be no assurance that Biomerica will be able to obtain regulatory clearances for its current or any future products in the United States or in foreign markets.

In March 2006 the FDA conducted a routine inspection of the Company. The FDA noted five observations which needed correction. Management of the Company made a commitment to correct all of these observations within six weeks of the date of inspection, and has notified the FDA that it has done so.

EUROPEAN COMMUNITY - Biomerica is required to obtain certification in the European community to sell products in those countries. The certification requires Biomerica to maintain certain quality standards. Biomerica has been granted certification and undergoes annual audits to assure that the Company

remains in compliance with regulations. There is no assurance that Biomerica will be able to retain its certification in the future.

RISK OF PRODUCT LIABILITY - Testing, manufacturing and marketing of Biomerica's products entails risk of product liability. Biomerica currently has product liability insurance. There can be no assurance, however, that Biomerica will be able to maintain such insurance at a reasonable cost or in sufficient amounts to protect Biomerica against losses due to product liability. An inability to obtain sufficient insurance coverage could prevent or inhibit the commercialization of Biomerica'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.

HAZARDOUS MATERIALS - Biomerica's manufacturing and research and development involves the controlled use of hazardous materials and chemicals. Although Biomerica believes that safety procedures for handling and disposing of such materials comply with the standards prescribed by state and Federal regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event of such an accident, the Company could be held liable for any damages that result and any such liability could exceed the resources of the Company. The Company may incur substantial costs to comply with environmental regulations.

STOCK-BASED COMPENSATION

During 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "ACCOUNTING FOR STOCK-BASED COMPENSATION," which defines a fair value based method of accounting for stock-based compensation. However, SFAS 123 allows an entity to continue to measure compensation cost related to stock and stock options issued to employees using the intrinsic method of accounting prescribed by Accounting Principles Board Opinion No. 25 ("APB 25"), "ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES." Entities electing to remain with the accounting method of APB 25 must make pro forma disclosures of net (loss) income and (loss) earnings per share, as if the fair value method of accounting defined in SFAS 123 had been applied. The Company has elected to account for its stock-based compensation to employees under APB 25.

In December 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 148 ("SFAS 148"), "ACCOUNTING FOR STOCK-BASED COMPENSATION - TRANSITION AND DISCLOSURE - AN AMENDMENT TO SFAS NO. 123." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method on accounting for stock-based employee compensation. The implementation of SFAS No. 148 did not have a material effect on the Company's consolidated financial position or results of operations.

Pro forma information regarding loss per share is required by SFAS 123, and has been determined as if the Company had accounted for its employee stock options under the fair value method of SFAS 123. The fair value for these options was estimated at the date of grant using the Black Scholes option pricing model with the following assumptions for the years ended May 31, 2006 and 2005; risk free

interest rates ranging from 3.57% to 5.04%; dividend yield of 0%; expected life of the options ranging from five to ten years; and volatility factors of the expected market price of the Company's common stock ranging from 63% to 100%.

The Black Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the option vesting period. Adjustments are made for options forfeited prior to vesting. The effect on compensation expense, net loss, and net loss per share (basic and diluted) had compensation costs for the Company's stock option plans been determined based on fair value on the date of grant consistent with the provisions of SFAS 123 are as follows:

MAY 31,	2006
Income (loss) from continuing operations, as reported	$ 153,765
Plus: Stock-based employee compensation expense included in reported loss from continuing operations	2,444
Less: Stock-based employee compensation expense determined using fair value based method	(129,414)
Income (Loss) from continuing operations, pro forma	$ 26,795
Pro forma Income (Loss) from continuing operations per share - basic	$ 0.00
Pro forma (loss) from continuing operations per share - diluted	$ 0.00
Income from discontinued operations, as reported	$ 76,508
Plus: Stock-based employee compensation expense included in reported income from discontinued operations	--
Less: Stock-based employee compensation expense determined using fair value based method	--
Income from discontinued operations, pro forma	$ 76,508
Pro forma income from discontinued operations per share - basic	$ 0.01
Pro forma income from discontinued operations per share - diluted	$ 0.01

BIOMERICA, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R). SFAS No. 123R revised SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123R will require compensation costs related to share-based payment transactions to be recognized in the financial statement (with limited exceptions). The amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. Compensation cost will be recognized over the period that an employee provides service in exchange for the award. Effective June 1, 2006, Biomerica will be required to comply with the provisions of this Statement.

In March 2005, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 107 ("SAB No. 107"), Share-Based Payment, providing guidance on option valuation methods, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123R, and the disclosures in MD&A subsequent to the adoption. The Company will provide SAB No. 107 required disclosures upon adoption of SFAS No. 123R on June 1, 2006 and is currently evaluating the impact the adoption of the standard will have on the Company's financial condition, results of operations, and cash flows.

In April 2005, the Securities and Exchange Commission adopted a new rule that amends the compliance dates for SFAS No. 123R. The Statement requires that compensation cost relating to share-based payment transactions be recognized in financial statements and that this cost be measured based on the fair value of the equity or liability instruments issued. SFAS No. 123R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The Company will adopt SFAS No. 123R on June 1, 2006 and is currently evaluating the impact the adoption of the standard will have on the Company's results of operations.

MINORITY INTEREST

Minority interest represents the minority shareholders' proportionate share of the equity of Lancer. At May 31, 2006, Biomerica owned 88.9% of ReadyScript (see Notes 3 and 11). ReadyScript's results of operations are reported under discontinued operations. At May 31, 2005 Biomerica owned 23.41% of Lancer, however as of December 1, 2005, the Lancer financials were no longer being reported on a consolidated basis due to the decreased ownership in Lancer.

REVENUE RECOGNITION

Revenues from product sales are recognized at the time the product is shipped, customarily FOB shipping point, at which point title passes. An allowance is established when necessary for estimated returns as revenue is recognized.

SHIPPING AND HANDLING FEES AND COSTS

The consolidated financial statements reflect, for all periods presented, the adoption of the classification or disclosure requirements pursuant to Emerging Issues Task Force ("EITF") 00-10, "Accounting for Shipping and Handling Fees and Costs." The Company has historically classified income from freight charges to customers as sales, which has been offset by shipping and handling costs. The

income from freight for the fiscal years 2006 and 2005, respectively, was $106,501 and $107,857. The financial statements presented herein show the income from shipping and handling as a component of sales for both periods and the costs of shipping and handling as a component of cost of goods sold. Fiscal 2005 revenue and cost of sales were adjusted to reflect compliance with EITF 00-10.

RESEARCH AND DEVELOPMENT

Research and development expenses are expensed as incurred. The Company expensed $239,004 and $274,288 of research and development expenses during the years ended May 31, 2006 and 2005, respectively. Included in these expenses was $42,470 and $96,218 incurred by Lancer for the six month period ended November 30, 2005 and the year ended May 31, 2005, respectively.

INCOME TAXES

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "ACCOUNTING FOR INCOME TAXES." Under the asset and liability method of Statement No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under Statement No. 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for certain deferred tax assets if it is more likely than not that the Company will not realize tax assets through future operations.

ADVERTISING COSTS

The Company reports the cost of all advertising as expense in the period in which those costs are incurred. Advertising costs were approximately $71,700 and $96,700 for the years ended May 31, 2006 and 2005, respectively. The fiscal 2006 costs include the first six months of the fiscal year for Lancer. Stand-alone advertising costs for Biomerica were $46,052 and $51,820 for the fiscal years 2006 and 2005, respectively.

CURRENCY

The functional currency for the Lancer De Mexico subsidiary is dollars. Accordingly, all transactions are recorded using dollars and no adjustments, gains and losses on intercompany currency transactions are recorded.

LOSS PER SHARE

In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 128 ("SFAS 128"), "EARNINGS PER SHARE" ("EPS"). SFAS 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/(loss) divided by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock options, warrants and other convertible securities.

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

	FOR THE YEARS ENDED MAY 31, 2006	2005
Numerator:		
Income (loss) from continuing operations	$ 153,765	$ (21,464)
Income from discontinued operations	76,508	183,723
Numerator for basic and diluted net income per common share	$ 230,273	$ 162,259
Denominator for basic net income per common share	5,759,082	5,752,431
Effect of dilutive securities:		
Options and warrants	461,253	866,690
Denominator for diluted net income per common share	6,220,335	6,619,121
Basic net income per common share:		
Income from continuing operations	$ 0.03	$ 0.00
Income) from discontinued operations	0.01	0.03
Basic net income per common share	$ 0.04	$ 0.03
Diluted net income per common share:		
Income from continuing operations	$ 0.02	$ 0.00
Net income from discontinued operations	0.01	0.03
Diluted net income per common share	$ 0.03	$ 0.03

SEGMENT REPORTING

The FASB has issued SFAS No. 131 "DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION". SFAS 131 requires public companies to report information about segments of their business in their annual financial

statements and requires them to report selected segment information in their quarterly reports issued to shareholders. It also requires entity-wide disclosures about the product, services an entity provides, the material countries in which it holds assets and reports revenues, and its major customers. The Company's business segments are disclosed in Note 8.

REPORTING COMPREHENSIVE INCOME

In June 1997, the FASB issued SFAS No. 130, "REPORTING COMPREHENSIVE INCOME." This statement establishes standards for reporting the components of comprehensive income (loss) and requires that all items that are required to be recognized under accounting standards as components of comprehensive income (loss) be included in a financial statement that is displayed with the same prominence as other financial statements. Comprehensive income (loss) includes net income (loss) as well as certain items that are reported directly within a separate component of shareholders' equity.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R). SFAS No. 123R revised SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123R will require compensation costs related to share-based payment transactions to be recognized in the financial statement (with limited exceptions). The amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. Compensation cost will be recognized over the period that an employee provides service in exchange for the award.

In March 2005, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 107 ("SAB No. 107"), Share-Based Payment, providing guidance on option valuation methods, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123R, and the disclosures in MD&A subsequent to the adoption. The Company will provide SAB No. 107 required disclosures upon adoption of SFAS No. 123R on June 1, 2006 and is currently evaluating the impact the adoption of the standard will have on the Company's financial condition, results of operations, and cash flows.

In April 2005, the Securities and Exchange Commission adopted a new rule that amends the compliance dates for SFAS No. 123R. The Statement requires that compensation cost relating to share-based payment transactions be recognized in financial statements and that this cost be measured based on the fair value of the equity or liability instruments issued. SFAS No. 123R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The Company will adopt SFAS No. 123R on June 1, 2006 and is currently evaluating the impact the adoption of the standard will have on the Company's results of operations.

In June 2005, the FASB issued SFAS No. 154, Accounting Changes and Errors Corrections, a replacement of APB Opinion No. 20 and SFAS No. 3. The Statement applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impractical. APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS No.154 improves the financial reporting because its requirements enhance the consistency of financial reporting between periods. The Company does not believe the adoption of this standard had an impact on its results of operations.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Sttements No. 133 and 140 ("SFAS No. 155"). This statement resolves issues addressed in SFAS No. 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interest in Securitized Financial Assets. SFAS No. 155: (a) permits fair value remeasurement for any hybrid financial instrument that contains an imbedded derivative that otherwise would require bifurcation; (b) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133; (c) establishes a requirement to evaluate beneficial interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; (d) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and, (e) eliminates restrictions on a qualifying special-purpose entity's ability to hold passive dereivative financial instruments that pertain to beneficial interests that are or contain a derivative financial instrument. SFAS No. 155 also requires presentation within the financial statements that identifies those hybrid financial instruments for which the fair value election has been applied and information on the income statement impact of the changes in fair value of those instruments. The Company is required to apply SFAS No. 155 to all financial instruments acquired, issued or subject to a remeasurement event beginning June 1, 2007. The Company does not expect the adoption of SFAS No. 155 to have a material impact on the Company's financial statements.

3. CONSOLIDATED SUBSIDIARIES

Lancer is engaged in the design, manufacture and distribution of orthodontic products. Biomerica's direct ownership percentage of Lancer was 23.41% at May 31, 2005 and its direct and indirect (via agreements with certain shareholders/directors) voting control over Lancer was greater than 50% as of

May 31, 2005. As a result of Biomerica's control and ownership, the Company's financial statements were consolidated with those of Lancer. During the fiscal year ending May 31, 2005, Biomerica was a party to certain informal agreements with certain of Lancer's officers and directors, pursuant to which they agreed to vote in the same manner as Biomerica (and its directors holding shares of Lancer's common stock) on matters requiring the approval of Lancer's

stockholders. Biomerica's percentage of direct ownership in Lancer has continued to decrease due to Lancer's issuance of additional shares of its common stock. As of December 1, 2005, the above-mentioned board members reserved their right no longer to vote their shares of Lancer in the same manner as the Biomerica board votes Biomerica's shares of Lancer. Therefore, effective as of December 1, 2005, Lancer's financial statements were no longer consolidated with those of Biomerica because Biomerica no longer has direct or indirect control of more than 50% of Lancer's common stock. As of December 1, 2005, Biomerica held less than 20% of Lancer's common stock and therefore Biomerica's investment is accounted for under the provision of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities".

The ReadyScript subsidiary was a development-stage enterprise and required the raising of a significant amount of capital to fund its short-term working capital needs. The ReadyScript operations were discontinued in May 2001 (see Note 11). The net assets and operating results of ReadyScript are included in the accompanying consolidated financial statements as discontinued operations.

Operating results for Lancer (for the six month period ended November 30, 2005) and ReadyScript (as discussed) in the aggregate for the years ended May 31, 2006 and 2005, which are included in the consolidated operating results of the Company, are as follows:

	FOR THE YEARS ENDED MAY 31,	
	2006	2005
Net sales	$ 2,925,038	$ 5,951,457
Cost of sales	2,190,495	4,150,254
Gross profit	734,543	1,801,203
Operating expenses:		
Selling, general and administrative	1,029,059	2,044,460
Research and development	42,470	96,218
Total operating expenses	1,071,529	2,140,678
Other income (expense):		
Interest expense, net	(14,456)	(9,097)
Other income, net	33,096	58,166
Total other income (expense)	18,640	49,069
(Loss) from continuing operations before income taxes	(318,346)	(290,406)
Income tax expense	800	1,138
(Loss) from continuing operations	(319,146)	(291,544)
Discontinued operations of ReadyScript:		
Income from discontinued operations, net	76,508	183,723
Net (loss)	$ (242,638)	$ (107,821)

BIOMERICA, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MAY 31, 2006 AND 2005

4. INTANGIBLE ASSETS

Intangible assets, net of accumulated amortization, consist of the following:

MAY 31,	2006
Patents and other intangibles	$ 36,465
Less accumulated amortization	28,702
	$ 7,763

5. RELATED PARTY TRANSACTIONS

NOTES PAYABLE -SHAREHOLDER

Biomerica, Inc. entered into an agreement for a line of credit agreement on September 12, 2000 with a shareholder whereby the shareholder would loan to the Company, as needed, up to $500,000 for working capital needs. The line of credit bore interest at 8%, was secured by accounts receivable and inventory, and expired September 13, 2003. In March 2004 the Company signed a note payable for the principal and interest due at that time of $313,318 and agreed to a forbearance of any payments for the length of the agreement. A warrant for 40,000 shares of restricted common stock exercisable at a price of $.51 per share was awarded as compensation for the forbearance. The note payable is secured by all the Company's assets except for the Lancer common stock owned by Biomerica. The note was due September 1, 2004. On November 19, 2004, the Company entered into an agreement entitled "Amendment of the Note, Loan and Modification Agreement" and "Amended And Restated Promissory Note" which were included as exhibits to the Form 10QSB filed April 14, 2004. The Amendment of the Note, Loan And Modification Agreement was filed as an exhibit to a Form 8K filed November 24, 2004. The agreement extended the maturity date of the note until August 31, 2005 and allows for minimum payments of $4,000 per month and additional contingent payments of up to $3,500 per month based on the Company's quarterly performance. During fiscal 2006 the due date on the note was extended until September 1, 2006, at the same terms and conditions. Collateral remains the same under The Amendment. There was $260,942 of outstanding principal and $0 of interest payable under this note payable at May 31, 2006. Although the Company is currently out of compliance with the terms of the loan agreement, in August 2006 the note holder agreed to extend the due date on the note payable until September 1, 2007. The terms of the note are the same except that additional payments of $3,500 per month, depending on quarterly results of the Company, have been reduced to $2,000 per month. Of the additional payments of $10,500 per quarter due for the quarters ended August 31, 2005, November 30, 2005 and February 28, 2006, only $5,250 has been paid.

During 2006 and 2005, the Company incurred $22,355 and $25,017, respectively, in interest expense related to the shareholder note payable.

During 2005 and 2004, a shareholder/director advanced the Company $0 and $4,000, respectively. Interest for the fiscal year ended May 31, 2006 and 2005 was $0

and $320. At May 31, 2006 and 2005, $1,659 and $1,979, respectively, were owed in interest payable on this loan and a previous loan of $10,000. During fiscal 2006, $320 of interest due on the $4,000 was forgiven by the shareholder/director.

RENT EXPENSE

Biomerica, Inc. leases facilities from an individual and a partnership, owned by shareholders of the Company. Gross rent expense of approximately $158,000 and $148,000 was incurred during 2006 and 2005, respectively, for this lease. A further expense of $4,765 has been included in accounts payable representing late fees, insurance and interest payable on outstanding rent. Rent payable at May 31, 2006 was $94,860. The total of rent, late fees, insurance and interest payable of $99,625 is included in accounts payable in the consolidated balance sheet.

ACCRUED COMPENSATION

During fiscal 2002-2005, two officers, who are also shareholders of the Company, agreed to defer payment of a portion of their salaries. At May 31, 2006 approximately $264,548 of deferred officer's salary is included in accrued compensation in the accompanying consolidated financial statements. During fiscal 2006 one of the officers agreed to participate in the Company's private placement in part by reducing his accrued compensation by approximately $20,000 in exchange for restricted common stock (Note 6).

Included in accrued compensation as of May 31, 2006 is vacation accrual of $166,863. Of this, approximately $121,000 is due to the former chief executive officer's estate. The Company is disputing the validity of this claim.

6. SHAREHOLDERS' EQUITY

1991, 1995 AND 1999 STOCK OPTION AND RESTRICTED STOCK PLANS

In December 1991, the Company adopted a stock option and restricted stock plan (the "1991 Plan") which provides that non-qualified options and incentive stock options and restricted stock covering an aggregate of 350,000 of the Company's unissued common stock may be granted to officers, employees or consultants of the Company. Options granted under the 1991 Plan may be granted at prices not less than 85% of the then fair market value of the common stock, vest at not less than 20% per year and expire not more than 10 years after the date of grant.

In January 1996, the Company adopted a stock option and restricted stock plan (the "1995 Plan") which provides that non-qualified options and incentive stock options and restricted stock covering an aggregate of 500,000 of the Company's unissued common stock may be granted to affiliates, employees or consultants of the Company. Options granted under the 1995 Plan may be granted at prices not less than 85% of the then fair market value of the common stock and expire not more than 10 years after the date of grant.

In August 1999, the Company adopted a stock option and restricted stock plan (the "1999 Plan") which provides that non-qualified options and incentive stock options and restricted stock covering an aggregate of 1,000,000 of the Company's unissued common stock may be granted to affiliates, employees or consultants of the Company. As of January 1, of each calendar year, commencing January 1, 2000, this amount is subject to automatic annual increases equal to the lesser of 1.5% of the total number of outstanding common shares, assuming conversion of convertible securities, or 500,000. Options granted under the 1999 Plan may be granted at prices not less than 85% of the then fair market value of the common stock and expire not more than 10 years after the date of grant.

Activity as to stock options and warrants granted are as follows:

	NUMBER OF STOCK OPTIONS	PRICE RANGE PER SHARE	WEIGHTED AVERAGE EXERCISE PRICE
Options and warrants outstanding at			
May 31, 2004	3,657,637	$ .20 - $3.00	$2.26
Options or warrants granted	244,000	$ .33 - $0.40	$0.35
Options and warrants canceled or expired	(2,299,000)	$ .20 - $3.00	$2.86
Options and warrants outstanding at May 31, 2005	1,602,637	$ 0.20 - $3.00	$0.90
Options or warrants granted	691,500	$ 0.47 - $0.65	0.44
Options exercised	(14,250)	$ 0.20 - $0.33	0.24
Options and warrants canceled or expired	(378,937)	$ .20 - $3.00	1.39
Options and warrants outstanding at May 31, 2006	1,900,950	$ .20 - $3.00	$0.64

The weighted average fair value of options and warrants granted during 2006 and 2005 was $0.44 and $0.35 respectively.

The following summarizes information about all of the Company's stock options and warrants outstanding at May 31, 2006. These options and warrants comprise of those granted under the 1991, 1995 and 1999 plan and those granted outside of these plans.

RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING MAY 31, 2006	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE IN YEARS	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT MAY 31, 2006	WEIGHTED AVERAGE EXERCISE PRICE

$ .20 - $ .33	737,000	2.23	$ .27	737,000	$ .27
$ 0.40 - $0.87	944,075	4.02	$ .46	642,325	$ .49
$ 1.90 - $3.00	219,875	2.24	$ 2.65	219,875	$ 2.65

STOCK ACTIVITY

During fiscal 2005, Biomerica granted 169,000 stock options to purchase shares of common stock at an exercise price of $.33 to select employees and consultants of the Company. The options vest over four years, and have a term of five years. Management assigned a value of $3,500 to these options. These options were granted under the Company's existing 1995 and 1999 Stock Option and Restricted Stock Plan.

During fiscal 2005, Biomerica granted 75,000 stock options to purchase shares of common stock at an exercise price of $.40 to outside directors and the President. The options vest over four years, and have a term of five years. Management assigned a value of $21,750 to these options.

In June 2005 the Company granted 111,000 stock options to purchase shares of common stock at an exercise price of $.53 to outside directors and the president. The options vest over four years, and have a term of five years. Management assigned a value of $37,405 to these options.

In September 2005 the Company granted 10,000 stock options to purchase shares of common stock at an exercise price of $.47 to an employee. The options vest over four years, and have a term of five years. Management assigned a value of $3,200 to these options.

In February 2006 the Company granted 20,000 stock options to purchase shares of common stock at an exercise price of $.48 to two employees. The options vest over four years, and have a term of five years. Management assigned a value of $5,520 to these options.

In May 2006 the Company granted 498,500 stock options to purchase shares of common stock at an exercise price of $.40 to various employees, consultants, officers and directors. The options vest over three years, and have a term of five years. Management assigned a value of $118,643 to these options.

In May 2006 the Company granted warrants to purchase 52,000 shares of restricted common stock at an exercise price of $.65 as part of the private placement conducted at that time. The options vest immediately and have a term of five years. Management assigned a value of $9,880 to these warrants.

During fiscal 2006 an employee of the Company exercised a stock option for 750 shares at the purchase price of $.20 per share and 750 shares at the purchase price of $.33 per share. The total proceeds to the Company was $398.

During fiscal 2006 a former employee (then a consultant) of the Company exercised a stock option for 3,000 shares at the purchase price of $.20 per share. The total proceeds to the Company was $600.

During fiscal 2006 a former employee (then a consultant) of the Company exercised a stock option for 6,000 shares at the purchase price of $.20 per share and 3,750 shares at $.33 per share. The total proceeds to the Company was $2,438.

During fiscal 2006 the board of directors approved a private placement of the Company's restricted common stock. There was a total of 156,000 shares sold at the purchase price of $.48 per share. One warrant at the exercise price of $.65 was granted for every three shares of restricted common purchased. Total proceeds to the Company was $74,880, of which $54,920 was to be paid in cash and the balance was a reduction of accrued wages. Three investors participated, one of whom was an officer and director. Of the $74,880, $24,960 was recorded as a receivable at year-end. This amount was paid after year-end in June 2006.

Options or warrants granted are assigned values according to current market value, using the Black-Scholes model for option valuation. The term used in the calculation of the options or warrants is the vesting period. A discount rate equivalent to five-year (or other life of the option or warrant) Treasury constant maturity interest rates is utilized. The historical volatility of the stock is calculated using weekly historical closing prices for the prior year as reported by Yahoo Finance. For purposes of the SFAS 123 footnote disclosure, the Black-Scholes Model is also used for calculating employee options and warrants valuations.

When shares are issued for services or other non-cash consideration, fair value is measured using the current market value on the day of the board approval of such issuance.

SUBSIDIARY SALE OF STOCK

During the years ended May 31, 2006 and 2005 the Company recognized a reduction in its additional paid capital in the amount of $57,769 and $31,494, respectively, resulting from a decrease in its ownership percentage of Lancer as a result of Lancer's sale of common stock. The Company treated this reduction in its equity of the subsidiary as an equity transaction in the accompanying consolidated statement of shareholder's equity.

SUBSIDIARY OPTIONS, WARRANTS AND STOCK ACTIVITY

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

In fiscal 2006 Lancer conducted a private placement, the purpose of which was to raise funds to proceed with the terms of the Lingualcare agreement. Lancer sold 722,769 shares of restricted common stock at the price of $.65 per share. Total gross proceeds to Lancer were $469,800. This private placement further reduced Biomerica's control and ownership percentage in Lancer.

7. INCOME TAXES

Income tax expense from continuing operations for the years ended May 31, 2006 and 2005 consists of the following current provisions:

MAY 31,	2006	2005
U.S. Federal	$ --	$ --
State and local	1,600	1,938
	$ 1,600	$ 1,938

Income tax expense from continuing operations differs from the amounts computed by applying the U.S. Federal income tax rate of 35 percent to pretax loss as a result of the following:

MAY 31,	2006	2005
Computed "expected" tax expense (benefit)	$ 81,366	$(24,734)
Increase (reduction) in income taxes resulting from:		
Lancer loss	27,494	--
Tax credits	(13,711)	--
Meals and entertainment	--	4,326
Change in valuation allowance	(94,000)	91,991
Equity in earnings of affiliates not subject to taxation because of dividends- received deduction for tax purposes	--	(71,583)
State income taxes, net of federal benefit	13,358	1,938
Other	(12,907)	--
	$ 1,600	$ 1,938

The tax effect of temporary differences that give rise to significant portions of liabilities are presented below.

MAY 31,	
Deferred tax assets (liabilities):	
Accounts receivable, principally due to allowance for doubtful accounts and sales returns	
Inventories, due to additional costs inventoried for tax purposes and allowance for obsolescence	
Compensated absences and deferred payroll	
Net operating loss carryforwards	
Tax credit carryforards	
Accumulated depreciation of property and equipment	
Other	

Less valuation allowance	
Net deferred tax asset (liability)	

The Company has provided a valuation allowance for all of its deferred tax assets as of May 31, 2006. Management provided such allowance as it is currently more likely than not that the Company will not generate taxable income sufficient to realize such assets in foreseeable future reporting periods. During fiscal 2006 the valuation allowance related to Biomerica on a stand alone basis decreased by $94,000.

The 2005 valuation allowance included amounts relating to the valuation allowance for Lancer Orthodontics. The valuation allowance decreased approximately $951,000 from 2005 as a result of the de-consolidation of Lancer during December 2005.

At May 31, 2006, the Company has federal and state income tax net operating loss carry forwards of approximately $3,105,000 and $1,013,000 respectively. The federal net operating loss carry forwards begin to expire in 2008. The state net operating loss carry forwards expire beginning in 2006.

At May 31, 2006 the Company has federal and California research and development tax credit carryforwards of approximately $91,000 and $57,000 respectively. The federal credits begin to expire in 2009 and the California credits carryforward indefinitely.

Pursuant to Internal Revenue Code Sections 382 and 383, annual use of the Company's net operating loss ("NOL") and credit carryforwards will be limited by statute because of a cumulative change in ownership of more than 50%. The Company has had numerous equity transactions that may have resulted in several changes in ownership of us as defined by Section 382 of the Internal Revenue Code of 1986, as amended, or the Code. Pursuant to Sections 382 and 383 of the Code, the annual use of the Company's NOLs would be limited if there is a cumulative change of ownership (as that term is defined in Section 382(g) of the Code) of greater than 50% in the past three years. Should Section 382 ownership change have occurred, there would be a substantial limitation on the Company's ability to utilize its NOLs to offset future taxable income.

8. BUSINESS SEGMENTS

Reportable business segments are identified by product line and for the years ended May 31, 2006 and 2005 are as follows (the amounts for Lancer's orthodontic sales for fiscal 2006 include results for only the six months ended November 30, 2005):

	2006	2005
Domestic sales:		
Orthodontic products	$ 1,584,000	$ 2,923,000

Medical diagnostic products	$ 1,168,000	$ 996,000
Foreign sales:		
Orthodontic products	$ 1,341,000	$ 3,028,000
Medical diagnostic products	$ 3,092,000	$ 2,435,000
Net sales:		
Orthodontic products	$ 2,925,000	$ 5,951,000
Medical diagnostic products	4,260,000	3,431,000
Total	$ 7,185,000	$ 9,382,000
Operating profit (loss):		
Orthodontic products	$ (337,000)	$ (340,000)
Medical diagnostic products	224,000	70,000
Total	$ (113,000)*	$ (270,000)*

*THE INCOME STATEMENT REPORTED A LOSS OF $97,000 AND $235,000 FOR FISCAL 2006 AND 2005, RESPECTIVELY. THE DIFFERENCE OF $16,000 AND $35,000 FOR FISCAL 2006 AND 2005, RESPECTIVELY, IS ATTRIBUTABLE TO INTERCOMPANY ELIMINATION ENTRIES UPON CONSOLIDATION.

Operating income from discontinued segment:		
ReadyScript	$ 76,508	$ 183,723
Total	$ 76,508	$ 183,723
Domestic long-lived assets:		
Orthodontic products	$ --	$ 571,000
Medical diagnostic products	115,000	121,000
Total	$ 115,000	$ 692,000
Foreign long-lived assets:		
Orthodontic products	$ --	$ 114,000
Medical diagnostic products	12,000	11,000
Total	$ 12,000	$ 125,000
Total assets:		
Orthodontic products	$ --	$ 4,144,000
Medical diagnostic products	2,428,000	1,647,000
Total	$ 2,428,000	$ 5,791,000
Depreciation and amortization expense:		
Orthodontic products	$ 63,000	$ 90,000
Medical diagnostic products	59,000	69,000
Total	$ 122,000	$ 159,000

Capital expenditures:		
Orthodontic products	$ 575,000	$ 198,000
Medical diagnostic products	51,000	44,000
Total	$ 626,000	$ 242,000

The net sales as reflected above consist of sales to unaffiliated customers only as there were no significant intersegment sales during fiscal years 2006 and 2005. On a consolidated basis no customer accounted for 10% or more of the consolidated sales in the fiscal years ended May 31, 2006 and 2005. No customer accounted for 10% or more of Lancer Orthodontics' sales for the fiscal year ended May 31 2005. On an unconsolidated basis Biomerica has two customers each of which account for greater than 10% of its sales for the years ended May 31, 2006 and 2005.

Geographic information regarding net sales is as follows (fiscal 2006 includes sales for Lancer of the six month period ended November 2005, whereas fiscal 2005 includes the entire year then ended):

	2006	2005
Net sales:		
United States	$ 2,752,000	$ 3,919,000
Europe	2,678,000	3,111,000
South America	458,000	428,000
Middle East	134,000	374,000
Asia	405,000	259,000
Oceania	582,000	686,000
Other foreign	176,000	605,000
Total net sales	$ 7,185,000	$ 9,382,000

Identifiable assets by business segment are those assets that are used in the Company's operations in each industry. Identifiable assets are held primarily in the United States.

9. COMMITMENTS AND CONTINGENCIES

OPERATING LEASES

Biomerica leased its primary facility under a non-cancelable operating lease, which expired October 31, 2005, with initial monthly base rent of $15,000 with a 3% increase effective September 1, 2003. The facilities are currently being leased on a month-to-month basis while management explores various leasing options including moving the Company to other facilities. The facilities are owned and operated by four of the Company's shareholders, one of whom is an officer and director. During fiscal 2004 through 2006 the Company consolidated some of its operations and the landlords agreed to take back the space no longer

needed by the Company and to reduce the rent accordingly. The landlords also agreed not to institute the 3% increase as required in the lease. Effective May 1, 2006 the monthly rent was set at $14,000. Management believes there would be no significant difference in the terms of the property rental if the Company leased from a third party. Total rent expense for this facility was approximately $158,000 and $148,000 during the years ended May 31, 2006 and 2005, respectively.

Biomerica subleased a portion of its facility under a non-cancelable operating lease, which expired May 16, 2003 and was month-to-month until April 1, 2006, at which time the Company returned this space to the landlord. The Company recorded base rental income of $15,478 and $28,104 during the years ended May 31, 2006 and 2005, respectively.

Biomerica has various small leases for office equipment.

RETIREMENT SAVINGS PLAN

Effective September 1, 1986, the Company established a 401(k) plan for the benefit of its employees. The plan permits eligible employees to contribute to the plan up to the maximum percentage of total annual compensation allowable under the limits of Internal Revenue Code Sections 415, 401(k) and 404. The Company, at the discretion of its Board of Directors, may make contributions to the plan in amounts determined by the Board each year. No contributions by the Company have been made since the plan's inception.

LITIGATION

The Company is, from time to time, involved in legal proceedings, claims and litigation arising in the ordinary course of business. While the amounts claimed may be substantial, the ultimate liability cannot presently be determined because of considerable uncertainties that exist. Therefore, it is possible the outcome of such legal proceedings, claims and litigation could have a material effect on quarterly or annual operating results or cash flows when resolved in a future period. However, based on facts currently available, management believes such matters will not have a material adverse affect on the Company's consolidated financial position, results of operations or cash flows.

CONTRACT

During the first quarter of fiscal 2006 the Company entered into an agreement with another company for the purpose of developing certain technology for Biomerica. The total amount of the contract was for $55,000, with a 40% down payment required and milestone payments for the balance of the contract. The balance due at May 31, 2006 was $33,000. On June 5, 2006, a milestone payment of $16,500 was made and which was included in payables as of May 31, 2006. The remaining $16,500 has not been recorded as a liability at May 31, 2006 due to the fact that payment of it is contingent upon performance at a future date of certain functions by the contractor.

10. CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY

The following is a condensed, unconsolidated balance sheet for Biomerica, Inc. as of May 31, 2006, and the condensed, unconsolidated pro forma statements of operations and condensed unconsolidated statements of cash flows for the years ended May 31, 2006 and 2005. No cash dividends were paid by the consolidated subsidiaries (see Note 3) during the years ended May 31, 2006 and 2005.

CONDENSED UNCONSOLIDATED BALANCE SHEET

MAY 31,	2006
ASSETS	
CURRENT ASSETS:	
Cash	$ 119,914
Available-for-sale securities	3,279
Accounts Receivable, Net	560,721
Inventories	1,104,367
Prepaid Expenses And Other	57,668
Total Current Assets	1,845,949
Inventory, Non-Current	23,663
Property And Equipment, Net	127,391
Intangible Assets	7,763
Available-For-Sale Securities	410,137
Other Assets	13,419
	$ 2,428,322
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts Payable And Accrued Liabilities	$ 580,767
Accrued Compensation	483,308
Capital lease - short-term portion	3,714
Current Portion Of Notes Payable-Shareholder	260,942
Net liabilities from discontinued operations	27,270
Total Current Liabilities	1,356,001

Capital lease - long-term portion	8,574
SHAREHOLDERS' EQUITY:	
Common Stock	461,333
Additional Paid-In Capital	17,064,324
Common stock subscribed	74,880
Common stock subscribed receivable	(24,960)
Accumulated Other Comprehensive Income	(226,971)
Accumulated Deficit	(16,284,859)

Total Shareholders' Equity	1,063,747
	$ 2,428,322

CONDENSED UNCONSOLIDATED STATEMENT OF OPERATIONS

MAY 31,	2006
Net Sales	$ 4,259,954
Cost Of Sales	2,604,900
Gross Profit	1,655,054
Operating Expenses:	
Selling, General And Administrative	1,234,404
Research And Development	196,534
Total Operating Expenses	1,430,938
Operating Income (Loss)	224,116
Other Income (Expense)	(2,075)
Income From Operations Before Interest In Net Loss (Income) Of Consolidated Subsidiaries And Income Taxes	222,041
Interest In Net Loss Of Consolidated Subsidiaries	67,476
Interest In Net Income Of Consolidated Subsidiaries - Discontinued Operations	(76,508)
Income From Operations Before Income Taxes	231,073
Income Tax Expense	800
Net Income	$ 230,273

BIOMERICA, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MAY 31, 2006 AND 2005

PRO FORMA STATEMENT OF OPERATIONS BY COMPANY

Year Ended
May 31, 2006

Actual	Intercompany Eliminations	Lancer Pro-forma adjustments	S

NET SALES	$ 7,184,992		$ (2,925,038)	
COST OF SALES	4,779,615	$ 15,780(1)	(2,190,495)	
GROSS PROFIT	2,405,377	$ (15,780)	(734,543)	
OPERATING EXPENSES:				
SELLING, GENERAL AND ADMIN	2,263,463		(1,029,059)	
RESEARCH AND DEVELOPMENT	239,004		(42,470)	
TOTAL OPERATING EXPENSES	2,502,467		(1,071,529)	
OPERATING INCOME (LOSS)	(97,090)	(15,780)	336,986	
OTHER (INCOME)EXPENSE				
Interest expense	44,790		(14,456)	
Other expense (income)	(45,575)	(15,780)(2)	33,096	
	(785)	(15,780)(2)	18,640	
INCOME (LOSS) FROM OPERATIONS BEFORE INTEREST IN NET INCOME (LOSS) OF CONSOLIDATED SUBSIDIARIES AND INCOME TAXES	(96,305)		318,346	
MINORITY INTEREST IN NET LOSS (INCOME) OF LANCER	251,670	(319,146)(3) 67,476 (4)	--	
INCOME (LOSS) FROM OPERATIONS BEFORE INCOME TAXES	155,365	(251,670)	318,346	
INCOME TAX EXPENSE	1,600		(800)	
DISCONTINUED OPERATION	(76,508)			
NET INCOME (LOSS)	$ 230,273	$ (251,670)	$ 319,146	$

(1) To record the charge for rent by Lancer at the manufacturing facility in Mexico which was el
consolidation.
(2) To record the income from Biomerica received by Lancer for rent at the Mexico facility, whic
eliminated in consolidation.
(3) To de-consolidate Lancer's loss.
(4) Elimination of Biomerica's portion of Lancer's operations as if the termination of the votin
occurred May 31, 2005.

PRO FORMA STATEMENT OF OPERATIONS BY COMPANY

	Year Ended May 31, 2005			
	Actual	Intercompany Eliminations	Lancer Pro-forma adjustments	S
NET SALES	$ 9,381,837		($5,951,457)	$
COST OF SALES	6,296,755	34,500(1)	(4,150,254)	
GROSS PROFIT	3,085,082	(34,500)(1)	(1,801,203)	
OPERATING EXPENSES:				
SELLING, GENERAL AND ADMIN	3,045,558		(2,044,460)	
RESEARCH AND DEVELOPMENT	274,288		(96,218)	
TOTAL OPERATING EXPENSES	3,319,846		(2,140,678)	
OPERATING (LOSS) INCOME	(234,764)	(34,500)(1)	339,475	
OTHER EXPENSE (INCOME)				
Interest expense	40,693		(9,097)	
Other expense (income)	(35,970)	(34,500)(2)	58,166	
	4,723	(34,500)(2)	49,069	
(LOSS) INCOME FROM OPERATIONS BEFORE INTEREST IN NET INCOME (LOSS) OF CONSOLIDATED SUBSIDIARIES AND INCOME TAXES	(239,487)		290,406	
MINORITY INTEREST IN NET LOSS (INCOME) OF LANCER	219,961	(291,544)(3) 71,583 (4)	--	
INCOME (LOSS) FROM OPERATIONS BEFORE INCOME TAXES	(19,526)	(219,961)	290,406	
INCOME TAX EXPENSE	1,938		(1,138)	
DISCONTINUED OPERATION	(183,723)			
NET INCOME (LOSS)	$ 162,259	$ (219,961)	$ 291,544	$

(1) To record the charge for rent by Lancer at the manufacturing facility in Mexico which was el
in consolidation.
(2) To record the income from Biomerica received by Lancer for rent at the Mexico facility, whic
eliminated in consolidation.
(3) To de-consolidate Lancer's loss.
(4) Elimination of Biomerica's portion of Lancer's operations as if the termination of the votin
agreement occurred May 31, 2004.

CONDENSED UNCONSOLIDATED STATEMENT OF CASH FLOWS

Certain amounts in fiscal 2005 Condensed Unconsolidated Statement of Cash Flows, have been re-classified to conform to the current year classification.

FOR THE YEARS ENDED MAY 31,	2006	
Cash Flows From Operating Activities:		
Net Income (loss) From Continuing Operations	$ 153,765	$
Adjustments To Reconcile Net Income (Loss) To Net Cash Provided (Used) In Operating Activities:		
Depreciation and Amortization	62,278	
Provision For Losses On Accounts Receivable	(3,361)	
Realized Gain On Sale Of Available-For-Sale Securities	(685)	
Loss Of Subsidiaries	67,476	
Options and Warrants Issued	12,324	
Loss On Disposal Of Property And Equipment	1,704	
Net Change In Other Current Assets And Current Liabilities	(203,234)	
Net Cash Provided By (Used In) Operating Activities	90,267	
Cash Flows From Investing Activities:		
Sales Of Available-For-Sale Securities	685	
Purchase Of Property And Equipment	(41,075)	
Net Cash (Used In) Provided By Investing Activities	(40,390)	

Cash Flows From Financing Activities:		
Net Decrease (Increase) In Shareholder Loans	(40,145)	
Exercise Of Stock Options	3,435	
Sale Of Common Stock, Net Of Offering Expenses	29,960	
Payments on capital lease	(553)	
Decrease (increase) In Notes Receivable	3,419	
Net Cash (Used In) Provided By Financing Activities	(3,884)	
Net cash provided by (used in) discontinued operations	(800)	
Net Change In Cash And Cash Equivalents	45,193	
Cash And Cash Equivalents At Beginning Of Year	74,721	
Cash And Cash Equivalents At End Of Year	$ 119,914	$

Supplemental Disclosure Of Cash Flow Information -

Cash Paid During The Year For:		
Interest	$ 29,379	$
Income Taxes	$ 800	$
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES		
Change in unrealized holding gain (loss) on available-for-sale securities	$(227,496)	$
Change in minority interest due to subsidiary sale of stock	$ (57,769)	$
Capital lease for purchase of fixed assets	$ 12,841	$
Increase in investment due to de-consolidation of Lancer	$ 632,732	$
Reduction of accrued compensation through purchase of stock	$ 19,960	$
Subscribed stock receivable	$ 24,960	$

BIOMERICA, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MAY 31, 2006 AND 2005

11. DISCONTINUED OPERATIONS

The following summarizes the net liabilities of the discontinued operations, ReadyScript, as of May 31, 2006 and the results of its operations for each of the years in the two-year period ended May 31, 2006.

Balance sheet items:

MAY 31,	2006
Assets:	
Miscellaneous receivable	$ 7,711
Less liabilities:	
Accrued expenses	34,981
Net liabilities	$ 27,270

Results of its operations items:

YEARS ENDED MAY 31,	2006	2005
Legal settlements and debt forgiveness	$ 77,308	$177,372
Cost and expenses:		
General and administrative (reduction of previous expenses)	800	6,351
Total costs and expenses	800	6,351
Income from operations	$ 76,508	$183,723

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BIOMERICA, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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12. SUBSEQUENT EVENTS

During August 2006 the Company and the holder of the Note Payable-shareholder described in Note 5 agreed to the extension of the note payable due date until September 1, 2007. The terms of the note payable are the same except that additional payments of $3,500 per month, depending on quarterly results of the Company, have been reduced to $2,000 per month.

In July 2006 a one year distribution agreement was entered into with Grifols USA, LLC wherein Grifols was appointed as a non-exclusive distributor in the United States for certain of the Company's products.