HEMACARE CORP /CA/
Form 10-Q
August 12, 2005

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2005

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 0-15223

HEMACARE CORPORATION

(Exact name of registrant as specified in its charter)

California	**95-3280412**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
21101 Oxnard Street	
Woodland Hills, California	**91367**
(Address of principal executive offices)	(Zip Code)

(818) 226-1968

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

As of August 9, 2005, 8,166,060 shares of Common Stock of the registrant were issued and outstanding.

HEMACARE CORPORATION AND SUBSIDIARIES

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FOR THE THREE AND SIX MONTHS ENDED

JUNE 30, 2005

PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

HEMACARE CORPORATION
CONSOLIDATED BALANCE SHEETS

	June 30, 2005 (Unaudited)	December 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 2,626,000	$ 2,082,000
Accounts receivable, net of allowance for doubtful accounts $73,000 in 2005 and $153,000 in 2004	3,066,000	3,378,000
Product inventories and supplies	684,000	566,000
Prepaid expenses	707,000	401,000
Other receivables	125,000	110,000
Total current assets	7,208,000	6,537,000
Plant and equipment, net of accumulated depreciation and amortization of $3,798,000 in 2005 and $3,470,000 in 2004	2,564,000	2,778,000
Other assets	40,000	29,000
	$ 9,812,000	$ 9,344,000
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	$ 1,467,000	$ 1,730,000
Accrued payroll and payroll taxes	1,249,000	1,175,000
Other accrued expenses	206,000	274,000
Current obligations under capital leases	262,000	253,000
Current obligations under notes payable	21,000	37,000
Total current liabilities	3,205,000	3,469,000
Obligations under capital leases, net of current portion	571,000	701,000
Notes payable, net of current portion		2,000
Other long-term liabilities	2,000	5,000
Commitments and contingencies		
Shareholders equity:		
Common stock, no par value 20,000,000 shares authorized, 8,166,060 and 8,064,060 issued and outstanding in 2005 and 2004	13,681,000	13,530,000
Accumulated deficit	(7,647,000)	(8,363,000)
Total shareholders equity	6,034,000	5,167,000
	$ 9,812,000	$ 9,344,000

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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HEMACARE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three months ended June 30,		**Six months ended June 30,**	
	2005	**2004**	**2005**	**2004**
Revenues:				
Blood products	$ 5,862,000	$ 5,036,000	$ 11,480,000	$ 9,881,000
Blood services	1,659,000	1,885,000	3,124,000	3,776,000
Total revenue	7,521,000	6,921,000	14,604,000	13,657,000
Operating costs and expenses:				
Blood products	4,547,000	4,179,000	8,968,000	8,237,000
Blood services	1,208,000	1,239,000	2,405,000	2,486,000
Total operating costs and expenses	5,755,000	5,418,000	11,373,000	10,723,000
Gross profit	1,766,000	1,503,000	3,231,000	2,934,000
General and administrative expenses	1,321,000	1,015,000	2,510,000	2,200,000
Income before income taxes	445,000	488,000	721,000	734,000
Provision for income taxes	5,000		5,000	
Net income	$ 440,000	$ 488,000	$ 716,000	$ 734,000
Basic earnings per share	$ 0.05	$ 0.06	$ 0.09	$ 0.09
Diluted earnings per share	$ 0.05	$ 0.06	$ 0.08	$ 0.09
Weighted average shares outstanding basic	8,106,000	7,756,000	8,090,000	7,756,000
Weighted average shares outstanding diluted	8,806,000	8,089,000	8,807,000	7,999,000

The accompanying notes are an integral part of these unaudited consolidated financial statements.

HEMACARE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six months ended June 30, 2005	2004
Cash flows from operating activities:		
Net income	$ 716,000	$ 734,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for bad debts	(13,000)	90,000
Recognition of deferred tax assets		(47,000)
Depreciation and amortization	332,000	334,000
(Gain) loss on disposal of assets	(3,000)	18,000
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	325,000	(9,000)
(Increase) in inventories, supplies and prepaid expenses	(424,000)	(80,000)
(Increase) decrease in other assets and other receivables	(26,000)	8,000
Increase (decrease) in accounts payable, accrued expenses and other liabilities	(260,000)	353,000
Net cash provided by operating activities	647,000	1,401,000
Cash flows from investing activities:		
Proceeds from sale of plant and equipment	13,000	16,000
Proceeds from note receivables		20,000
Purchases of plant and equipment	(128,000)	(67,000)
Net cash used in investing activities	(115,000)	(31,000)
Cash flows from financing activities:		
Proceeds from the exercise of stock options	19,000	
Proceeds from sale of common stock	132,000	
Principal payments on debt and capitalized leases	(139,000)	(906,000)
Net cash provided by (used in) financing activities	12,000	(906,000)
Increase in cash and cash equivalents	544,000	464,000
Cash and cash equivalents at beginning of period	2,082,000	935,000
Cash and cash equivalents at end of period	$ 2,626,000	$ 1,399,000
Supplemental disclosure:		
Interest paid	$ 33,000	$ 55,000
Income taxes paid (refunded)	$ (17,000)	$ 30,000
Items not affecting cash flow:		
Insurance premiums financed	$	$ 188,000

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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HemaCare Corporation
Notes to Unaudited Consolidated Financial Statements

Note 1 Basis of Presentation and General Information

BASIS OF PRESENTATION

In the opinion of management, the accompanying unaudited consolidated financial statements for the three and six months ended June 30, 2005 and 2004 include all adjustments (consisting of normal recurring accruals) which management considers necessary to present fairly the financial position of the Company as of June 30, 2005, the results of its operations for the three and six months ended June 30, 2005 and 2004, and its cash flows for the six months ended June 30, 2005 and 2004 in conformity with accounting principles generally accepted in the United States. These financial statements have been prepared consistently with the accounting policies described in the Company s Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Securities and Exchange Commission on March 25, 2005 which should be read in conjunction with this Quarterly Report on Form 10-Q. The results of operations for the three and six months ended June 30, 2005 are not necessarily indicative of the consolidated results of operations to be expected for the full fiscal year ending December 31, 2005. Certain information and footnote disclosures normally included in the financial statements presented in accordance with accounting principles generally accepted in the United States have been condensed or omitted.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

CONCENTRATION OF CREDIT RISK

The Company maintains cash balances at various financial institutions. Deposits not exceeding $100,000 for each institution are insured by the Federal Deposit Insurance Corporation. At June 30, 2005 and December 31, 2004, the Company had uninsured cash and cash equivalents of $2,410,000 and $1,864,000, respectively.

Note 2 Line of Credit and Notes Payable

The Company, together with Coral Blood Services, Inc., a subsidiary, has a working capital line of credit with Comerica Bank California. This credit facility originally was scheduled to terminate as of June 30, 2005; however, on July 1, 2005, the Company, Coral Blood Services, Inc. and Comerica Bank entered into an amendment to the credit facility to extend the term of the facility to June 30, 2007. In addition, this amendment altered the interest rate calculation, established a $50,000 maximum limit for purchasing or disposing of assets without Comerica Bank s approval, and removed the restriction in the agreement on the Company s ability to purchase, acquire, repurchase, retire or redeem any of the Company s capital stock. As of July 1, 2005, the amount the Company may borrow is the lesser of: 75% of eligible accounts receivable or $2 million. Interest is payable monthly at a rate of prime minus 0.25%; as of June 30, 2005 the rate associated with this note was 5.75%. In addition, the Company has the option to draw against this facility for thirty (30), sixty (60), or ninety (90) days using LIBOR as the relevant rate of interest. As of June 30, 2005, the Company had no net borrowing on this line of credit, and the Company had unused availability of $2,000,000.

The Comerica loan is collateralized by substantially all of the Company s assets and requires the maintenance of certain financial covenants that among other things require minimum levels of profitability and prohibits the payment of dividends. As of June 30, 2005 the Company was in full compliance with all of the financial covenants. During the second quarter of 2005, the Company did not incur any interest expense associated with the Comerica loan.

Additionally, the Company has another note payable to One Source Financial. As of June 30, 2005, the balance on this note was $21,000, which is due in full on January 25, 2006. The note requires quarterly payments of approximately $10,000 including interest at a fixed rate of 8.5% and is secured by certain fixed assets. The entire balance is included in current obligations under notes payable on the balance sheet.

The Company also has a capital equipment lease with Gambro BCT to finance the acquisition of equipment used in the Company s apheresis activities. As of June 30, 2005, the balance outstanding on this lease was $703,000, of which approximately $179,000 is included in current obligations under capital leases on the balance sheet. The lease is scheduled to terminate in December 2008 and has a fixed interest of 7.5%. The lease is secured by all of the equipment purchased through the lease financing.

The Company also has a capital equipment lease with GE Capital used to finance the acquisition of vehicles. As of June 30, 2005, the balance outstanding on this lease was $123,000, of which $76,000 is included in current obligations. This lease is scheduled to terminate in January 2007, and has a fixed interest rate of 8.0%.

The Company has a capital equipment lease with Dell Financial Services associated with the acquisition of computer equipment. As of June 30, 2005, the balance outstanding on this lease was $2,000, all of which is included in current obligations. This lease is scheduled to terminate in August 2005, and has a fixed interest rate of 12.6%. The Company has no plans to renew this lease.

Finally, the Company has a capital equipment lease with Toshiba Financial Services associated with the acquisition of photocopier equipment. As of June 30, 2005, the balance outstanding on this lease was $5,000, all of which is included in current obligations. This lease is scheduled to terminate in May 2006.

Note 3 Shareholders Equity

The Company has elected to adopt SFAS 123, Accounting for Stock-Based Compensation, for disclosure purposes only and applies the provision of APB Opinion No. 25. The Company did not recognize any compensation expense related to the issuance of stock options in 2005 or 2004. Had compensation expense for all options granted to employees and directors been recognized in accordance with SFAS 123, the Company s net income (loss) per share would have been as follows:

	Three months ended June 30, 2005	**2004**	**Six months ended June 30, 2005**	**2004**
Net income as reported	$ 440,000	$ 488,000	$ 716,000	$ 734,000
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	19,000	23,000	152,000	63,000
Pro forma net income:	$ 421,000	$ 465,000	$ 564,000	$ 671,000
Net income per share basic				
As reported	$ 0.05	$ 0.06	$ 0.09	$ 0.09
Pro forma	$ 0.05	$ 0.06	$ 0.07	$ 0.09
Net income per share diluted				
As reported	$ 0.05	$ 0.06	$ 0.08	$ 0.09
Pro forma	$ 0.05	$ 0.06	$ 0.06	$ 0.09

The Company recognized $22,000 in compensation expense in the second quarter of 2005 related to the purchase of 80,000 shares of the Company s common stock through the Employee Stock Purchase Plan (Plan). The Plan requires that the payment of a price be based on an average of the closing price in the Company s common stock for a period of ten (10) trading days starting two (2) trading days following an earnings announcement. The average price for the period following the Company s first quarter 2005 earnings announcement was $1.37 per share. The Plan provides that purchasers have five (5) business days to complete any purchase after the purchase price is determined. On June 7, the day these 80,000 shares were purchased, the closing price for the Company s stock was $1.65. Accounting rules require that any discount in the price paid for stock through such plans from the price available in the marketplace should be recognized as compensation expense to the Company.

Note 4 Earnings per Share

The following table provides the calculation methodology for the numerator and denominator for diluted earnings per share:

	Three months ended June 30, 2005	**2004**	**Six months ended June 30, 2005**	**2004**
Net income	$ 440,000	$ 488,000	$ 716,000	$ 734,000
Weighted Average Shares outstanding	8,106,000	7,756,000	8,090,000	7,756,000
Net effect of dilutive options andwarrants	700,000	333,000	717,000	243,000
Diluted shares outstanding	8,806,000	8,089,000	8,807,000	7,999,000

In December 2004, the FASB issued SFAS No. 123R (revised 2004), Share-Based Payment . SFAS No. 123R supersedes APB Opinion No. 25, and requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim or annual period after June 15, 2005. The pro forma disclosure permitted under SFAS No.123 will no longer be an alternative to financial statement recognition. SFAS No. 123R requires the determination of the fair value of the share-based compensation at the grant date and the recognition of the related expense over the period in which the share-based compensation vests. On April 21, 2005, the Securities and Exchange Commission amended Regulation S-X to change the adoption date of SFAS No. 123R to the first interim period in the first fiscal year beginning after June 15, 2005. The Company, therefore, is required to adopt the provisions of SFAS No. 123R effective January 1, 2006.

Options and warrants outstanding of 465,000 shares and 175,000 shares of common stock for the three and six months ended June 30, 2005, respectively, have been excluded from the above calculation because their effect would have been anti-dilutive.

Options and warrants outstanding of 635,000 shares and 650,000 shares of common stock for the three and six months ended June 30, 2004, respectively, have been excluded from the above calculation because their effect would have been anti-dilutive.

Note 5 Provision for Income Taxes

The Company has substantial net operating losses from prior periods that will be available in 2005 to eliminate most of any potential federal tax liability. The Company has recognized income in each of the last seven quarters, and as a result, and to the degree that the Company incurs any tax liability, the Company will reduce the valuation reserve against its deferred tax assets to reflect some potential future benefit from the future utilization of the Company s net operating losses. The Company will continue to evaluate the deferred tax asset valuation reserve each quarter based on the reportable income for each quarter. At this time, the Company will not reduce the 100% deferred tax valuation reserve, but may choose to reduce this reserve in future periods. The Company estimates that $5,000 in taxes, related to alternative minimum taxes, has been incurred as a result of reportable income during the second quarter of 2005.

Note 6 Business Segments

HemaCare operates two business segments as follows:

- Blood Products Collection, processing and distribution of blood products and donor testing.
- Blood Services Therapeutic apheresis, stem cell collection procedures and other therapeutic services to patients.

Management uses more than one measure to evaluate segment performance. However, the dominant measurements are consistent with HemaCare s consolidated financial statements, which present revenue from external customers and operating income for each segment.

Note 7 Exit and Disposal Activities

During the second quarter of 2004, the Company was informed by Dartmouth-Hitchcock Medical Center in Lebanon, New Hampshire and Presbyterian Intercommunity Hospital in Whittier, California that the Company s blood center management contracts with these hospitals would not be renewed upon expiration in June 2004. As a result, the Company incurred $4,000 for moving expenses associated with the closure of the donor center at Dartmouth-Hitchcock Medical Center. There were no closure costs related to the closure of the donor center at Presbyterian Intercommunity Hospital. The Company recorded revenues from the contract with Presbyterian Intercommunity Hospital of $294,000 in the first six months of 2004, and $129,000 in the second quarter of 2004. The Company recorded revenues from the contract with Dartmouth-Hitchcock Medical Center of $595,000 in the first six months of 2004, and $243,000 in the second quarter of 2004.

Note 8 Commitments and Contingencies

State and federal laws set forth anti-kickback and self-referral prohibitions and otherwise regulate financial relationships between blood banks and hospitals, physicians and other persons who refer business to them. While the Company believes its present operations comply with applicable regulations, there can be no assurance that future legislation or rule making, or the interpretation of existing laws and regulations will not prohibit or adversely impact the delivery by HemaCare of its services and products.

Healthcare reform is continuously under consideration by lawmakers, and it is not certain as to what changes may be made in the future regarding health care policies. However, policies regarding reimbursement, universal health insurance and managed competition may materially impact the Company s operations.

The Company is party to various claims, actions and proceedings incidental to its normal business operations. The Company believes the outcome of such claims, actions and proceedings, individually and in the aggregate, will not have a material adverse effect on the business and financial condition of the Company.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of the Company s financial condition and results of operations should be read in conjunction with the Company s financial statements and the related notes provided under Item 1 Financial Statements above.

The matters discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Quarterly Report on Form 10-Q that are not historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements may also be identified by the use of words such as anticipate, believe, continue, estimate, expect, intend, may, project, will and similar expressions, as they relate to the Company, its management and its industry. Investors and prospective investors are cautioned that these forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Actual results could differ materially from those described in this report because of numerous factors, many of which are beyond the Company s control. These factors include, without limitation, those described below under the heading Risk Factors Affecting our Business. The Company does not undertake to update its forward-looking statements to reflect later events and circumstances or actual outcomes.

General

HemaCare Corporation (HemaCare or the Company) collects, processes and distributes blood products to hospitals in the United States. The blood products distributed consists of those produced by the Company and purchased from other suppliers. Additionally, the Company provides blood related services, principally therapeutic apheresis procedures, stem cell collection and other blood treatments to patients with a variety of disorders. Blood related services are provided on an in-patient and out-patient basis under contract with hospitals, as an outside purchased service.

The Company has operated in Southern California since 1978. In 1998, the Company expanded operations to include portions of the eastern U.S. In 2003, new management completed a comprehensive evaluation of the Company s operations, and at the conclusion of this review developed and successfully implemented a restructuring plan to reduce the number of geographic areas served, reduce the overhead costs associated with supporting the organization, and improve the revenue potential from the remaining geographic areas served by the Company. Management s strategy is to continue to build upon its profitable foundation before exploring opportunities for growth in other geographic areas or into new lines of business.

In the second quarter of 2004, the donor center management contracts between the Company and Presbyterian Intercommunity Hospital, located in Whittier, California, and between the Company and Dartmouth-Hitchcock Medical Center, located in Lebanon, New Hampshire expired and were not renewed. The Company recorded $294,000 of revenue from the contract with Presbyterian Intercommunity Hospital in the first six months of 2004, and $129,000 in the second quarter of 2004, The Company recorded $595,000 of revenue from the contract with Dartmouth-Hitchcock Medical Center in the first six months of 2004, and $243,000 in the second quarter of 2004.

Although most blood suppliers are organized as not-for-profit, tax-exempt organizations, all suppliers charge fees for blood products to cover their costs of operations. The Company believes that it is the only investor-owned and taxable organization operating as a blood supplier with significant operations in the U.S.

On October 19, 2001, the Company filed an application for a patent with the United States Patent and Trademark Office for a method for high yield purification of immune globulins from blood plasma and blood plasma intermediates. On May 17, 2005, the United States Patent and Trademark Office issued Patent No. 6,893,639 B2 to the Company as acceptance of the Company s application. The Company intends to market this patented process to plasma fractionators, and others, who could benefit from this methodology.

Results of Operations

Three months ended June 30, 2005 compared to the three months ended June 30, 2004

Overview

The Company generated $440,000 net income for the second quarter of 2005, which represents $48,000, or 9.8%, less net income compared with the same period in 2004. Revenues for the quarter ended June 30, 2005 were $7,521,000, which represents a $600,000, or 8.7%, increase from $6,921,000 in the same period of 2004. Blood products revenue increased $826,000, or 16.4%, as a result of increased collection rates and increased sales of products purchased from other suppliers to satisfy customer demand. Blood services revenue decreased $226,000, or 12.0%, mostly as a result of a decrease in the number of procedures performed in the Southern California market. Higher overall revenues resulted in higher gross profit in the second quarter of 2005 compared with the second quarter of 2004; however, higher general and administrative expenses, mostly for consultants and other outside service providers, resulted in a decline in overall net income compared with the same period in 2004.

The results of the second quarter of 2005 do not include the activities of two business units the Company operated during the second quarter of 2004. During the second quarter of 2004, the Company was informed by Dartmouth-Hitchcock Medical Center in Lebanon, New Hampshire and Presbyterian Intercommunity Hospital in Whittier, California that the Company s blood center management contracts with these hospitals would not be renewed upon expiration in June 2004.

Blood Products

For this business segment, the following table summarizes the revenues, gross profit and sales volumes associated with donor centers still operated by the Company, and donor centers no longer operated as of June 30, 2005:

For the three month period ended June 30, 2005
(Revenues and Gross Profit in Thousands)

	Ongoing Centers		Closed Centers		Total Company	
	2005	2004	2005	2004	2005	2004
Revenues	$ 5,862	$ 4,713	$	$ 323	$ 5,862	$ 5,036
Gross Profit	1,315	806		51	1,315	857
Gross Profit %	22.4 %	17.1 %	N/A	15.8 %	22.4 %	17.0 %

For the three months ended June 30, 2005, revenues for this business segment increased $826,000, or 16.4%, when compared with the same quarter of 2004. The increase in revenue is directly attributable to higher sales volumes at the Company s ongoing donor centers, which generated $1,149,000, or 24.4%, more revenue in the quarter than in the second quarter of 2004. This increase in revenues is due to an increase in collections through the Company s operations, and an increase in sales of products purchased from other suppliers.

The substantial increase in blood products volume was partially offset by the loss of revenues from two donor centers the Company no longer operates. In the second quarter of 2004, the donor center management contracts between the Company and Presbyterian Intercommunity Hospital, located in Whittier, California, and between the Company and Dartmouth-Hitchcock Medical Center, located in Lebanon, New Hampshire expired and were not renewed. The Company recorded revenues from the contract with Presbyterian Intercommunity Hospital in the second quarter of 2004 of $129,000. The Company recorded revenues from the contract with Dartmouth-Hitchcock Medical Center in the second quarter of 2004 of $194,000.

For the three months ended June 30, 2005, gross profit for the blood products segment increased $458,000, or 53.4%, compared with the second quarter of 2004. All of this improvement is due to increasing gross profit at the Company s ongoing donor centers, which increased $509,000, or 63.1%, compared to the same quarter in 2004. The improvement in gross profit for the ongoing donor centers is attributable to higher sales volume, which was accomplished without a commensurate increase in operating costs. In addition, the gross profit percentage for ongoing donor centers improved over five percentage points to 22.4% in the second quarter of 2005, from 17.1% for the same quarter of 2004 as the result of i) increases in selected product prices and, ii) increased operational efficiencies realized from higher volumes.

Blood Services

Revenues from blood services decreased by $226,000, or 12.0%, to $1,659,000 in the second quarter of 2005 from $1,885,000 in the same period of 2004. This decrease was mainly due to an 11.6% decrease in the number of therapeutic apheresis procedures performed during the quarter compared with the same quarter in 2004. This decrease is due to several factors including (i) increased competition from other service providers in Southern California, (ii) ceasing in-patient services for a major customer in Maine, and (iii) the non-renewal of the Dartmouth-Hitchcock Medical Center contract in June of 2004.

Gross profit for the blood services segment decreased $195,000, or 30.2%, from $646,000 in the second quarter of 2004 to $451,000 during the same period of 2005. For the quarter, this business segment produced a gross profit percentage of 27.2%, compared with 34.3% for the same quarter in 2004. This decrease is primarily the result of a decrease in revenues and increases in nurse salaries due to increased competition for trained apheresis nurses. In addition, the Company has increased the number of staff and related expenses associated with the management and marketing of this business segment. These activities resulted in an overall reduction in the gross profit and gross profit percentage compared with the same period in 2004.

General and Administrative Expenses

General and administrative expenses increased by $306,000, or 30.1%, to $1,321,000 in the second quarter of 2005 from $1,015,000 in the same period of 2004. This increase was primarily due to a $98,000 increase in expense for outside services and temporary personnel, a $59,000 increase in accrued bonus expense, a $49,000 increase in salary expense, the recognition of $22,000 in compensation expense associated with the purchase of stock through the Employee Stock Purchase Plan, and a $20,000 increase in the cost of liability insurance. The increase in outside services and temporary personnel expenses is mostly related to recruitment costs associated with filling several key management level positions. In addition, the Company utilized temporary personnel to fill these vacant positions contributing to the higher expense in this category in 2005 compared with 2004. Bonus expense increased as a result of an increase in the accrual for management bonuses. The 2005 management bonus plan calls for an increase in bonus payments compared with 2004 if the Company achieves certain performance and profitability targets. Based on the results produced thus far, the Company has recognized an increase in bonus expense in anticipation that the higher bonus amounts, included in the bonus plan, will be paid. The increase in salary expense reflects higher compensation paid to senior management as approved by the Compensation Committee in March 2005 after completing an extensive evaluation of management compensation relative to the marketplace. The Company recognized $22,000 in compensation expense in the second quarter of 2005 related to the purchase of 80,000 shares of the Company s common stock through the Employee Stock Purchase Plan (Plan). The Plan requires that the payment of a price be based on an average of the closing price in the Company s common stock for a period of ten (10) trading days starting two (2) trading days following an earnings announcement. The average price for the period following the Company s first quarter 2005 earnings announcement was $1.37 per share. The Plan provides that purchasers have five (5) business days to complete any purchase after the purchase price is determined. On June 7, the day these 80,000 shares were purchased, the closing price for the Company s stock was $1.65. Accounting rules require that any discount in the price paid for stock through such plans from the price available in the marketplace should be recognized as compensation expense to the Company. Therefore, the Company recognized $22,000 in compensation expense related to this transaction in the second quarter of 2005, contributing to the overall increase in general and administrative expenses compared to the same quarter in 2004. Finally, the cost of general and professional liability insurance increased $20,000 compared with the second quarter of 2004 as most of the Company s insurance policies expired and renewed during the second quarter of 2005.

Income Taxes

The Company has sufficient net operating loss carryforward to avoid most federal income tax expense for the second quarter of 2005. However, management anticipates that the Company will be subject to federal alternative minimum tax in 2005. In addition, management anticipates that the Company will be subject to various state and local taxes which are unaffected by the net operating loss carryforward. Management has calculated an estimated tax liability that includes the potential for federal alternative minimum tax, and has calculated estimated tax liability for each state and local jurisdiction using the tax basis each jurisdiction uses to assess taxes. During the second quarter of 2005, the Company recorded $5,000 to the provision for income taxes based on these estimates.

Six months ended June 30, 2005 compared to the six months ended June 30, 2004

Overview

The Company generated $716,000 net income for the first six months of 2005, which represents $18,000, or 2.5%, less net income compared with the same period in 2004. Revenues for the period were $14,604,000, which represents a $947,000, or 6.9%, increase in revenue, from $13,657,000 generated during the same period in 2004. Blood products revenue increased $1,599,000, or 16.2%, as a result of increased collection rates and increased sales of products purchased from other suppliers. Blood services revenue decreased $652,000, or 17.3%, mostly as a result of a decrease in the number of procedures performed in the Southern California market. Higher overall revenues resulted in higher gross profit in the first six months of 2005 compared with the first six months of 2004; however, higher general and administrative expenses, mostly for consultants and other outside service providers, resulted in a decrease in net income compared with the same period in 2004.

The results generated during the first six months of 2005 do not include the activities of three business units the Company operated in the first six months of 2004. During the first quarter of 2004, management closed the donor center in Chapel Hill, North Carolina. During the second quarter of 2004, the Company was informed by Dartmouth-Hitchcock Medical Center in Lebanon, New Hampshire and Presbyterian Intercommunity Hospital in Whittier, California that the Company s blood center management contracts with these hospitals would not be renewed upon expiration in June 2004.

Blood Products

For this business segment, the following table summarizes the revenues, gross profit and sales volumes associated with donor centers operated by the Company, and those donor centers the Company no longer operates as of June 30, 2005:

For the six month period ended June 30, 2005
(Revenues and Gross Profit in Thousands)

	Ongoing Centers		Closed Centers		Total Company	
	2005	2004	2005	2004	2005	2004
Revenues	$ 11,480	$ 9,039	$	$ 842	$ 11,480	$ 9,881
Gross Profit	2,512	1,462		182	2,512	1,644
Gross Profit %	21.9 %	16.2 %	N/A	21.6 %	21.9 %	16.6 %

For the six months ended June 30, 2005, revenues for this business segment increased $1,599,000, or 16.2%, when compared with the same period of 2004. The increase in revenue is directly attributable to higher sales volumes at the Company s ongoing donor centers, which generated $2,441,000, or 27%, more revenue in the period than in the same period of 2004. This increase in revenues is due to an increase in collections through the Company s operations, and sales of products purchased from other suppliers.

The substantial increase in blood products volume was partially offset by the loss of revenues from three donor centers the Company no longer operates. In the first quarter of 2004, management closed the donor center in Chapel Hill, North Carolina. In the first quarter of 2004, this donor center generated $65,000 in blood products revenue. In the second quarter of 2004, the donor center management contracts between the Company and Presbyterian Intercommunity Hospital, located in Whittier, California, and between the Company and Dartmouth-Hitchcock Medical Center, located in Lebanon, New Hampshire expired and were not renewed. The Company recorded revenues from the contract with Presbyterian Intercommunity Hospital in the first six months of 2004 of $294,000. The Company recorded revenues from the contract with Dartmouth-Hitchcock Medical Center in the first six months of 2004 of $483,000.

For the six months ended June 30, 2005, gross profit for the blood products segment increased $868,000, or 52.8%, compared with the same period of 2004. All of this improvement is due to increasing gross profit at the Company s ongoing donor centers, which increased $1,050,000, or 71.8%, compared to the same period in 2004. The improvement in gross profit for the ongoing donor centers is attributable to higher sales volume, which was accomplished without a commensurate increase in operating costs. In addition, the gross profit percentage for ongoing donor centers improved by more than 5 and one half percentage points to 21.9% in the first six months of 2005, from 16.3% for the same period of 2004 as the result of i) increases in selected product prices and, ii) increased operational efficiencies realized from higher volumes.

Blood Services

Revenues from blood services decreased by $652,000, or 17.3%, to $3,124,000 in the first six months of 2005 from $3,776,000 in the same period of 2004. The decrease was mainly due to a 17.3% decrease in the number of therapeutic apheresis procedures performed, primarily in the Company s Southern California market. This decrease is due to several factors including (i) competition from other service providers in Southern California, (ii) ceasing in-patient services for a major customer in Maine, and (iii) and the non-renewal of the Dartmouth-Hitchcock Medical Center contract in June 2004.

Gross profit for the blood services segment decreased $571,000, or 44.3%, from $1,290,000 in the first six months of 2004 to $719,000 during the same period in 2005. For the first six months of 2005, this business segment produced a gross profit percentage of 23%, compared with 34.2% for the same period in

2004. This decrease is primarily the result of a decrease in revenues and increases in nurse salaries due to increased competition for trained apheresis nurses. In addition, the Company has increased the number of staff and related expenses associated with the management and marketing of this business segment. These activities resulted in an overall reduction in the gross profit and gross profit percentage. Compared with the first quarter of 2005, this segments gross profit percentage increased almost 5 percentage points from 18.3%. Most of this improvement is attributable to efficiencies derived from higher procedure volumes.

General and Administrative Expenses

General and administrative expenses increased by $310,000, or 14.1%, to $2,510,000 in the first six months of 2005 from $2,200,000 in the same period of 2004. This increase was primarily due to a $270,000 increase in expense for outside services, consultants and temporary personnel in support of a variety of projects, a $92,000 increase in accrued bonus expense, a $26,000 increase in the cost of liability insurance, and the recognition of $22,000 in compensation expense associated with the purchase of stock through the Employee Stock Purchase Plan. Offsetting these expenses was a $103,000 reduction in bad debt expense. The increase in outside services, consultants and temporary personnel expenses is mostly related to recruitment costs associated with filling several key management level positions. In addition, the Company utilized temporary personnel to fill these vacant positions contributing to the higher expense in this category in 2005 compared with 2004. Bonus expense increased as a result of an increase in the accrual for management bonuses. The 2005 management bonus plan calls for an increase in bonus payments compared with 2004 if the Company achieves certain performance and profitability targets. Based on the results produced thus far, the Company has recognized an increase in bonus expense in anticipation that the higher bonus amounts, included in the bonus plan, will be paid. The increase in liability insurance is the result of premium increases associated with the Company s professional liability insurance, which was renewed in the second quarter of 2005. Finally, $22,000 in compensation expense was recognized in the first six months of 2005 related to the purchase of 80,000 shares of the Company s common stock through the Employee Stock Purchase Plan (Plan). The Plan requires that the price to purchase shares shall be based on an average of the closing price in the Company s common stock for a period of ten (10) trading days starting two (2) trading days following an earnings announcement. The average price for the period following the Company s first quarter 2005 earnings announcement was $1.37 per share. The Plan provides that purchasers have five (5) business days to complete any purchase after the purchase price is determined. On June 7, the day the 80,000 shares were purchased, the closing price for the Company s stock was $1.65. Accounting rules require that any discount in the price paid for stock through such plans from the price available in the marketplace should be recognized as compensation expense to the Company. Therefore, the Company recognized $22,000 in compensation expense related to this transaction in the first six months of 2005, contributing to the overall increase in general and administrative expenses compared to the same period in 2004. The offsetting reduction in bad debt expense experienced by the Company during the first six months of 2005 was the result of improved collection efforts. During the first half of 2004, the Company experienced an increase in bad debts expense associated with the disruption in collections caused by the implementation of management s restructuring plan that closed six donor centers in late 2003. Since then, the Company s collections have stabilized, and as a result the bad debt expense experienced in the first six months of 2005 decreased significantly compared with the same period in 2004.

Income Taxes

The Company has sufficient net operating loss carryforward to avoid most federal income tax expense for the first six months of 2005. However, management anticipates that the Company will be subject to federal alternative minimum tax in 2005. In addition, management anticipates that the Company will be subject to various state and local taxes which are unaffected by the net operating loss carryfoward. Management has calculated an estimated tax liability that includes the potential for federal alternative minimum tax, and has calculated estimated tax liability for each state and local jurisdiction using the tax basis each jurisdiction uses to assess taxes. During the first six months of 2005, the Company recorded $5,000 to the provision for income taxes based on these estimates, all of which was recorded in the second quarter of the year.

Critical Accounting Policies and Estimates

Use of Estimates

The Company s discussion and analysis of its financial condition and results of operations are based on the Company s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to valuation reserves, income taxes and intangibles. The Company bases its estimates on historical experience and on various other assumptions that management believes are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Allowance for Doubtful Accounts

The Company makes ongoing estimates relating to the collectibility of accounts receivable and maintains a reserve for estimated losses resulting from the inability of customers to meet their financial obligations to the Company. In determining the amount of the reserve, management considers the historical level of credit losses and makes judgments about the creditworthiness of significant customers based on ongoing credit evaluations. Since management cannot predict future changes in the financial stability of customers, actual future losses from uncollectible accounts may differ from the estimates. If the financial condition of customers were to deteriorate, resulting in their inability to make payments, a larger reserve may be required. In the event it is determined that a smaller or larger reserve was appropriate, the Company would record a credit or a charge to general and administrative expense in the period in which such a determination is made.

Income Taxes

As part of the process of preparing the financial statements, the Company is required to estimate income taxes in each of the jurisdictions that the Company operates. This process involves estimating actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the balance sheet. Management must then assess the likelihood that the deferred tax assets will be recovered from future taxable income, and to the extent management believes that recovery is not likely, must establish a valuation allowance. To the extent a valuation allowance is created or adjusted in a period, the Company must include an expense, or benefit, within the tax provision in the statements of income.

Significant management judgment is required in determining the provision for income taxes, deferred tax asset and liabilities and any valuation allowance recorded against net deferred tax assets. Management continually evaluates if the deferred tax asset is likely to be realized. If management determines that the deferred tax asset is not likely to be realized, a write-down of that asset would be required and would be reflected in the provision for taxes in the accompanying period.

Liquidity and Capital Resources

As of June 30, 2005, the Company s cash and cash equivalents equaled $2,626,000 and the Company had working capital of $4,003,000.

The Company, together with Coral Blood Services, Inc., a subsidiary, has a working capital line of credit with Comerica Bank California. This credit facility originally was scheduled to terminate as of June 30, 2005; however, on July 1, 2005, the Company, Coral Blood Services, Inc. and Comerica Bank entered into an amendment to the credit facility to extend the term of the facility to June 30, 2007. In addition, this amendment altered the interest rate calculation, established a $50,000 maximum limit for purchasing or disposing of assets without Comerica Bank s approval, and removed the restriction in the agreement on the Company s ability to purchase, acquire, repurchase, retire or redeem any of the Company s capital stock. As of July 1, 2005, the amount the Company may borrow is the lesser of: 75% of eligible accounts receivable or $2 million. Interest is payable monthly at a rate of prime minus 0.25%; as of June 30, 2005 the rate associated with this note was 5.75%. In addition, the Company has the option to draw against this facility for thirty (30), sixty (60), or ninety (90) days using LIBOR as the relevant rate of interest. As of June 30, 2005, the Company had no net borrowing on this line of credit, and the Company had unused availability of $2,000,000.

The Comerica loan is collateralized by substantially all of the Company s assets and requires the maintenance of certain financial covenants that among other things require minimum levels of profitability and prohibits the payment of dividends. As of June 30, 2005 the Company was in full compliance with all of the financial covenants. During the second quarter of 2005, the Company did not incur any interest expense associated with the Comerica loan.

Additionally, the Company has another note payable to One Source Financial. As of June 30, 2005, the balance on this note was $21,000, which is due in full on January 25, 2006. The note requires quarterly payments of approximately $10,000 including interest at a fixed rate of 8.5% and is secured by certain fixed assets. The entire balance is included in current obligations under notes payable on the balance sheet.

The Company also has a capital equipment lease with Gambro BCT to finance the acquisition of equipment used in the Company s apheresis activities. As of June 30, 2005, the balance outstanding on this lease was $703,000, of which approximately $179,000 is included in current obligations under capital leases on the balance sheet. The lease is scheduled to terminate in December 2008 and has a fixed interest of 7.5%. The lease is secured by all of the equipment purchased through the lease financing.

The Company also has a capital equipment lease with GE Capital used to finance the acquisition of vehicles. As of June 30, 2005, the balance outstanding on this lease was $123,000, of which approximately $76,000 is included in current obligations. This lease is scheduled to terminate in January 2007, and has a fixed interest rate of 8.0%.

The Company has a capital equipment lease with Dell Financial Services associated with the acquisition of computer equipment. As of June 30, 2005, the balance outstanding on this lease was $2,000, all of which is included in current obligations. This lease is scheduled to terminate in August 2005, and has a fixed interest rate of 12.6%. The Company has no plans to renew this lease.

Finally, the Company has a capital equipment lease with Toshiba Financial Services associated with the acquisition of photocopier equipment. As of June 30, 2005, the balance outstanding on this lease was $5,000, all of which is included in current obligations. This lease is scheduled to terminate in May 2006.

The following table summarizes our contractual obligations by year (in thousands).

	Total	Less than 1 Year	1 3 Years	3 5 Years	More than 5 Years
Operating leases	$ 521	$ 175	$ 346	$	$
Capitalized leases	833	258	423	152	
Notes payable	21	21			
Totals	$ 1,375	$ 454	$ 769	$ 152	$

For the six months ended on June 30, 2005, net cash provided by operating activities was $647,000, compared to $1,401,000 for the six months ended June 30, 2004. The decrease of $754,000 in cash provided between the two periods is primarily due to an increase in inventories, supplies and prepaid expenses of $424,000 compared to only $80,000 in 2004. In the first six months of 2005, management decided not to finance any portion of the Company s general and professional liability insurance premiums upon renewal as had been the practice in the past. As a result, the Company paid $516,000 in insurance premiums during the first six months of 2005 that remained mostly as prepaid expense as of June 30, 2005. Also contributing to lower cash provided by operating activities is a net decrease in accounts payable, accrued expenses and other liabilities of $260,000 in the first six months of 2005, compared with a net increase of $353,000 for the same period in 2004. Management has chosen to utilize some of the recent increase in available cash to keep obligations to vendors closer to term; however, some of the swing in this category is related to the coincidental timing of payment of payroll and vendor obligations relative to the quarter end. Finally, offsetting the two accounts that provided cash from operating activities is a net decrease in accounts receivable of $325,000 compared with a net increase of $9,000 for the first six months of 2004. Although this represents a substantial swing from last year to this year, the days sales outstanding statistic as of June 30, 2005 stood at 42 days, which compares favorably to 46 days outstanding as of December 31, 2004.

For the six months ended on June 30, 2005, net cash used in investing activities was $115,000, compared with $31,000 for the same period in 2004. The increase of $84,000 is primarily due to the Company s investments in new vehicles and computer equipment expenditures during the first six months of 2005. The Company did not make similar investments in plant or equipment during the same period of 2004.

For the six months ended June 30, 2005, net cash provided by financing activities was $12,000 compared with net cash used of $906,000 for the six months ended June 30, 2004. The difference is due to (i) management s strategy to pay down debt during the first six months of 2004, whereas management did not choose to further reduce debt in 2005 beyond the scheduled debt reduction payments, and (ii) proceeds of $151,000 were received from the purchase of stock and exercise of stock options during the first six months of 2005, whereas no such proceeds were received during the first six months of 2004.

The Company had previously decided to initiate a new information technology project to enhance the automation of its blood product operations. The Company has identified a preferred blood bank information system developer to provide this system, and is currently in contract negotiations. This project is expected to take approximately two years to complete, and will involve considerable financial and managerial resources. Management expects approximately $2 million will be needed to complete this project.

Management anticipates that cash on hand and available borrowing on the bank line of credit will be sufficient to provide funding for the Company s needs during the next year, including working capital requirements, equipment purchases, operating lease commitments and to fund the new information technology project. The Company has entered into an amendment to the credit agreement with Comerica that extends the term of the line of credit to June 30, 2007.

The Company s primary sources of liquidity include our cash on hand, available borrowing on the line of credit and cash generated from operations. Liquidity depends, in part, on timely collections of accounts receivable. Any significant delays in customer payments could adversely affect the Company s liquidity. Liquidity also depends on maintaining compliance with the various loan covenants.

Risk Factors Affecting the Company

Short and long-term success is subject to many factors that are beyond management s control. Shareholders and prospective shareholders of the Company should consider carefully the following risk factors, in addition to other information contained in this report. The matters discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Quarterly Report on Form 10-Q that are not historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements may also be identified by the use of words such as anticipate, believe, continue, estimate, expect, intend, may, project, will and similar expressions, as they relate to the Company, its management and its industry. Investors and prospective investors are cautioned that these forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Actual results could differ materially from those anticipated in these forward-looking statements as a result of various risks and uncertainties, including those described below. The Company does not undertake to update its forward-looking statements to reflect later events and circumstances or actual outcomes.

Changes in demand for blood products could affect profitability

The Company s operations are structured to produce particular blood products based on the existing demand, and perceived potential changes in demand, for these products by customers. Sudden and unexpected changes in demand of these products could have an adverse impact on the Company s profitability. Increasing demand could harm relationships with customers if the Company is unable to alter production capacity, or purchase products from other suppliers, adequately to fill orders. This could result in a net decrease in overall revenues and profits. Decreases in demand may require the Company to make sizeable investments to restructure operations away from declining products to the production of new products. Lack of access to sufficient capital, or lack of adequate time to properly respond to such a change in demand, could result in declining revenue and profits as customers transfer to other suppliers.

Declining blood donations could affect profitability

The business depends on the availability of donated blood. Only a small percentage of the population donates blood, and new regulations intended to reduce the risk of introducing infectious diseases in the blood supply have decreased the pool of potential donors. If the level of donor participation declines, the Company may not be able to reduce costs sufficiently to maintain profitability in blood products.

Market prices may not rise as costs increase which could reduce profitability

The costs of collecting, processing and testing blood have risen significantly in recent years and will likely continue to increase. These cost increases are related to new and improved testing procedures to assure that blood is free of infectious disease, increased regulatory requirements related to blood safety, and increased costs associated with recruiting blood donors. New testing protocols have required the Company to outsource much of the required testing. Competition and fixed price contracts may limit the Company s ability to pass these increased costs to customers. Some competitors have greater resources than the Company to sustain periods of unprofitable sales. In this circumstance, the increased costs may reduce profitability and may have a material adverse effect on the business and results of operations.

New competitor may cause a loss of customers and an increase in costs and impact profitability

A new company recently began operations providing therapeutic apheresis services in direct competition with the Company. This new company has hired several of the Company s former employees, and as a result is aware of the Company s customer base, business strategies and resources. In addition, this new company has hired, or attempted to hire, many of the Company s trained apheresis nurses. This has caused the Company to incur significant recruitment costs to replace these nurses, and has caused the Company to dramatically increase nurses compensation. This new company has contracted with some of the Company s customers. Therefore, it is possible that the introduction of this new competitor will have a negative impact on the Company s future revenue for therapeutic apheresis services. In addition, it appears likely that the increase in costs associated with nurse retention and recruitment will negatively impact the future profitability for the blood services business segment.

Operations depend on obtaining the services of qualified medical professionals and competition for their services is strong

The Company is highly dependent upon obtaining the services of qualified medical professionals. In particular, the Company s blood services business segment depends on the services of registered nurses and other medical technologists. Nationwide, the demand for these professionals exceeds the supply and competition for their services is strong. This shortage could be aggravated in the event of a war or other international conflict or natural disaster. If the Company is unable to attract and retain a staff of qualified medical professionals, operations may be adversely affected.

Decrease in reimbursement rates may affect profitability

Reimbursement rates for blood products and services provided to Medicaid and Medicare patients impact the fees that the Company is able to negotiate with hospitals. Decreases in reimbursement rates or increases which do not keep pace with higher costs, may impact the Company s profitability.

Lease for a major production facility has expired and if the Company needs to vacate it may be unable to locate an alternative facility thereby disrupting business

The long-term lease for the Company s Sherman Oaks production facility has expired. The Company has been unable to negotiate a lease renewal. Presently, the Company continues to occupy this facility with the possibility of receiving a 30-day notice to vacate at any time. The lack of a long-term lease agreement for this facility could have an adverse impact on profitability if the Company receives a 30-day notice to vacate and is unable to locate an alternative facility. The Company s ability to produce platelet and whole blood products for Southern California customers may be severely impacted and result in a reduction of revenue and profitability.

Targeted partner blood drives involve higher collection costs

Part of the Company s current operations involves conducting blood drives in partnership with hospitals. Blood drives are conducted under the name of the hospital partner and require that all promotional materials and other printed material include the name of the hospital partner. This strategy lacks the efficiencies associated with blood drives that are not targeted to benefit particular hospital partners. As a result, collection costs might be higher than those experienced by the Company s competition and may affect profitability and growth plans.

Limited access to insurance could affect ability to defend against possible claims

The Company currently maintains insurance coverage consistent with the industry; however, if the Company experiences losses or the risks associated with the blood products industry increase in the future, insurance may become more expensive or unavailable. The Company also cannot give assurance that as the business expands, or the Company introduces new products and services, that additional liability insurance on acceptable terms will be available, or that the existing insurance will provide adequate coverage against any and all potential claims. Also, the limitations on liability contained in various agreements and contracts may not be enforceable and may not otherwise protect the Company from liability for damages. The successful assertion of one or more large claims against the Company that exceed available insurance coverage, or changes in insurance policies, such as premium increases or the imposition of large deductibles or co-insurance requirements, may materially and adversely affect the business.

Not-For-Profit status gives advantages to competitors since they are exempt from taxes

HemaCare is the only significant blood products supplier to hospitals in the U.S. that is operated for profit and investor owned. The not-for-profit competition is exempt from federal and state taxes, and has substantial community support and access to tax-exempt financing. The Company may not be able to continue to compete successfully with not-for-profit organizations and the business and results of operations may suffer material adverse harm.

Potential adverse effect from changes in the healthcare industry, including consolidations, could affect access to customers

Competition to gain patients on the basis of price, quality and service is intensifying among healthcare providers who are under pressure to decrease the costs of healthcare delivery. There has been significant consolidation among healthcare providers as providers seek to enhance efficiencies, and this consolidation is expected to continue. Many of the Company s customers have recently been sold, or are currently available for sale. As a result of these trends, the Company may be limited in its ability to increase prices for products in the future, even if costs increase. Further, customer attrition as a result of consolidation or closure of hospital facilities may adversely impact the Company.

Future technological developments, including the development of synthetic substitutes for blood products, could jeopardize business

As a result of the risks posed by blood-borne diseases, many companies are currently seeking to develop synthetic substitutes for human blood products. HemaCare s business consists of collecting, processing and distributing human blood and blood products. The introduction and acceptance in the market of synthetic blood substitutes may cause material adverse harm to the business. In addition, recent technological developments to extend the shelf-life of products currently offered by the Company, could increase the available supply in the market, and put downward pressure on the price for these products. This may cause a material adverse impact on the future profitability for these products.

Potential inability to meet future capital needs could affect plans to finance future expansion

Currently, the Company believes it has sufficient cash available through its cash on hand, bank credit facilities and funds from operations to finance its operations for the next year. The Company generated $1,545,000 in net income in 2004, and remained profitable in the first six months of 2005; however, there is no assurance this performance will be sustainable, and the Company may need to raise additional capital in the debt or equity markets. There can be no assurance that the Company will be able to obtain such financing on reasonable terms or at all. Additionally, there is no assurance that the Company will be able to obtain sufficient capital to finance future expansion.

Heavily regulated industry could increase operating costs

The business of collecting, processing and distributing blood and blood products are all subject to extensive and complex regulation by the state and federal governments. The Company is required to obtain and maintain numerous licenses in different legal jurisdictions regarding the safety of products, facilities and procedures, and regarding the purity and quality of blood products. In addition, state and federal laws include anti-kickback and self-referral prohibitions and other regulations that affect the relationships between blood banks, hospitals, physicians and other persons who refer business to each other. Health insurers and government payers, such as Medicare and Medicaid, also limit reimbursement for products and services, and require compliance with certain regulations before reimbursement will be made.

The Company devotes substantial resources to complying with laws and regulations, and believes it is currently in compliance; however, the possibility cannot be eliminated that interpretations of existing laws and regulations will result in a finding that the Company has not complied with significant existing regulations. Such a finding could materially harm the business. Moreover, healthcare reform is continually under consideration by regulators, and the Company does not know how laws and regulations will change in the future. Some of these changes may require costly compliance efforts or expensive outsourcing of functions which may cause some of the Company s operations to be prohibitively expensive or impossible to continue.

Product safety and product liability could provide exposure to claims and litigation

Blood products carry the risk of transmitting infectious diseases, including but not limited to hepatitis, HIV and Creutzfeldt-Jakob disease. HemaCare carefully screens donors, uses highly qualified testing service providers to test its blood products for known pathogens in accordance with industry standards, and complies with all applicable safety regulations. Nevertheless, the risk that screening and testing processes might fail or that new pathogens may be undetected by them cannot be completely eliminated. There is currently no test to detect the pathogen responsible for Creutzfeldt-Jakob disease. If patients are infected by known or unknown pathogens, claims may exceed insurance coverage and materially and adversely affect the Company s financial condition. Furthermore, healthcare regulations are constantly changing and certain changes may require costly compliance or make some of our operations impossible to continue.

Environmental risks could cause Company to incur substantial costs to maintain compliance

HemaCare s operations involve the controlled use of bio-hazardous materials and chemicals. Although the Company believes that its 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 and its insurance coverage. The Company may incur substantial costs to maintain compliance with environmental regulations as it develops and expands its business.

Business interruption due to terrorism and increased security measures in response to terrorism

HemaCare s business depends on the free flow of products and services through the channels of commerce and freedom of movement for patients and donors. The 2001 response to terrorist activities slowed or stopped transportation, mail, financial and other services for a period of time. Further delays or stoppages in transportation of perishable blood products and interruptions of mail, financial or other services could have a material adverse effect on the Company s results of operations and financial condition. Furthermore, the Company may experience an increase in operating costs, such as costs for transportation, insurance and security, as a result of the terrorist activities and potential activities, which may target health care facilities or medical products. The Company may also experience delays in receiving payments from payers that have been affected by terrorist activities and potential activities. The U.S. economy in general is adversely affected by terrorist activities, and potential activities, and any economic downturn may adversely impact the Company s results of operations, impair its ability to raise capital or otherwise adversely affect its ability to grow its business.

Articles of Incorporation and Rights Plan could delay or prevent an acquisition or sale of HemaCare

HemaCare s Articles of Incorporation empower the Board of Directors to establish and issue a class of preferred stock, and to determine the rights, preferences and privileges of the preferred stock. This gives the Board of Directors the ability to deter, discourage or make more difficult for a change in control of HemaCare, even if such a change in control would be in the interest of a significant number of shareholders or if such a change in control would provide shareholders with a substantial premium for their shares over the then-prevailing market price for our common stock.

In addition, the Board of Directors has adopted a Shareholder s Rights Plan designed to require a person or group interested in acquiring a significant or controlling interest in HemaCare to negotiate with the Board. Under the terms of our Shareholders Rights Plan, in general, if a person or group acquires more than 15% of the outstanding shares of common stock, all of the other shareholders would have the right to purchase securities from the Company at a discount to the fair market value of the common stock, causing substantial dilution to the acquiring person or group. The Shareholders Rights Plan may inhibit a change in control and, therefore, may materially adversely affect the shareholders ability to realize a premium over the then-prevailing market price for the common stock in connection with such a transaction. For a description of the Shareholders Rights Plan see the Company s Current Report on Form 8 K filed with the SEC on March 5, 1998.

Stocks traded on the OTC Bulletin Board are subject to greater market risks than those of exchange-traded and Nasdaq stocks since they are less liquid

HemaCare s common stock was delisted from the Nasdaq Small Cap Market on October 29, 1998 because of the failure to maintain Nasdaq s requirement of a minimum bid price of $1.00. Since November 2, 1998 the common stock has traded on the OTC Bulletin Board, an electronic, screen-based trading system operated by the National Association of Securities Dealers, Inc. Securities traded on the OTC Bulletin Board are, for the most part, thinly traded and generally are not subject to the level of regulation imposed on securities listed or traded on the Nasdaq Stock Market or on a national securities exchange. As a result, an investor may find it difficult to dispose of our common stock or to obtain accurate quotations as to its price.

Stock price could be volatile

The price of HemaCare s common stock has fluctuated in the past and may be more volatile in the future. Factors such as the announcements of government regulation, new products or services introduced by the Company or by the competition, healthcare legislation, trends in the health insurance, litigation, fluctuations in operating results and market conditions for healthcare stocks in general could have a significant impact on the future price of HemaCare s common stock. In addition, the stock market has from time to time experienced extreme price and volume fluctuations that may be unrelated to the operating performance of particular companies. The generally low volume of trading in HemaCare s common stock makes it more vulnerable to rapid changes in price in response to market conditions.

Future sales of equity securities could dilute the Company s common stock

The Company may seek new financing in the future through the sale of its securities. Future sales of common stock or securities convertible into common stock could result in dilution of the common stock currently outstanding. In addition, the perceived risk of dilution may cause some shareholders to sell their shares, which may further reduce the market price of the common stock.

Lack of dividend payments

The Company intends to retain any future earnings for use in its business, and therefore does not anticipate declaring or paying any cash dividends in the foreseeable future. The declaration and payment of any cash dividends in the future will depend on the Company s earnings, financial condition, capital needs and other factors deemed relevant by the Board of Directors. In addition, the Company s credit agreement prohibits the payment of dividends during the term of the agreement.

Evaluation of internal control and remediation of potential problems will be costly and time consuming and could expose weaknesses in financial reporting

The regulations implementing Section 404 of the Sarbanes-Oxley Act of 2002 require an assessment of the effectiveness of the Company s internal control over financial reporting beginning with our Annual Report on Form 10-K for the fiscal year ending December 31, 2006. The Company s independent auditors will be required to confirm in writing whether management s assessment of the effectiveness of the internal control over financial reporting is fairly stated in all material respects, and separately report on whether they believe management maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006.

This process will be expensive and time consuming, and will require significant attention of management. Management can give no assurance that material weaknesses in internal controls will not be discovered. Management also can give no assurance that the process of evaluation and the auditor s attestation will be completed on time. If a material weakness is discovered, corrective action may be time consuming, costly and further divert the attention of management. The disclosure of a material weakness, even if quickly remedied, could reduce the market s confidence in the Company s financial statements and harm the Company s stock price, especially if a restatement of financial statements for past periods is required.

In addition, HemaCare is a relatively small publicly traded company, and does not have the resources of other large publicly traded companies to fulfill all of the requirements of Section 404. If the Company is unable to adequately design its internal control systems, or prepare an internal control report to the satisfaction of the Company s auditors, the Company s auditors may issue a qualified opinion on the Company s financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company has $854,000 of debt, all of which is in the form of notes payable and capitalized leases with fixed interest rates. As of June 30, 2005, the Company has no debt at variable interest rates, and therefore there is no risk from changes in interest rates at this time. The Company has the ability to draw against the working capital line of credit, which has an interest rate linked to the prime interest rate. Accordingly, if the Company did draw against this line of credit, interest rate expense could fluctuate with rate changes in the U.S.

Item 4. Controls and Procedures

The Company s management, with the participation of the Company s chief executive officer and the principal financial officer, carried out an evaluation of the effectiveness of the Company s disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)). Based upon that evaluation, the chief executive officer and the principal financial officer believe that, as of the end of the period covered by this report, except as described below, the Company s disclosure controls and procedures were effective at the reasonable assurance level in making known to them in a timely manner material information relating to the Company (including its consolidated subsidiaries, required to be included in this report).

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity s disclosure objectives. The likelihood of achieving such objections is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures such as simple errors, mistakes or intentional circumvention of the established process.

There was no change in the Company s internal control over financial reporting, that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

The Company recently conducted an extensive evaluation of the existing internal control structure. Management identified several internal control weaknesses. Of these, the Company has alternative controls in place, which management believes prevents any material misstatement of the Company s financial statements. Nevertheless, management intends to modify the existing internal control structure to eliminate any significant weaknesses with the objective of eliminating or reducing reliance on alternative controls.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is involved in various routine legal proceedings incidental to the conduct of its business. Management does not believe that any of these legal proceedings will have a material adverse impact on the business, financial condition or results of operations of the Company, either due to the nature of the claims, or because management believes that such claims should not exceed the limits of the Company s insurance coverage.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

a. The Company s Annual Meeting of Shareholders (the Meeting) was held on May 24, 2005.

b. The following table shows the tabulation of votes for all matters put to vote at the Meeting:

Matters Put to Vote	**For**	**Against**	**Withheld**
1. *Election of Five Directors*			
Julian L. Steffenhagen	6,913,998	N/A	565,292
Judi Irving	7,397,409	N/A	81,881
Robert L. Johnson	6,918,198	N/A	561,092
Terry Van Der Tuuk	7,417,809	N/A	61,481
Steven B. Gerber, M.D.	7,428,659	N/A	50,631
2. *Amendment of 1996 Stock Incentive Plan to increase the number of shares that may be issued under the plan by 500,000*	862,655	754,591	6,550
3. *Ratification of the Appointment of Stonefield Josephson, Inc. as the Company s Independent Registered Public Accounting Firm for the fiscal year ending December 31, 2005.*	5,344,637	366,264	38,154

Item 5. Other Information

a. None

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Item 6. Exhibits

a. Exhibits

3.1	Restated Articles of Incorporation of the Registrant incorporated by reference to Exhibit 3.1 to Form 10-K of the Registrant for the year ended December 31, 2002.
3.2	Amended and Restated Bylaws of the Registrant, as amended, incorporated by reference to Exhibit 3.1 to Form 8-K of the Registrant dated February 20, 2003.
10.1	Second Modification to Loan and Security Agreement between HemaCare Corporation and Coral Blood Services, Inc., as borrower, and Comerica Bank dated July 1, 2005, incorporated by reference to Exhibit 10.1 to Form 8-K of the Registrant filed on July 6, 2005.
10.2	Change of Control Agreement between HemaCare Corporation and Judi Irving, President and Chief Executive Officer dated June 6, 2005, incorporated by reference to Exhibit 10.1 to Form 8-K of the Registrant filed on June 10, 2005.
10.3	Change of Control Agreement between HemaCare Corporation and Robert Chilton, Executive Vice President and Chief Financial Officer dated June 6, 2005, incorporated by reference to Exhibit 10.2 to Form 8-K of the Registrant filed on June 10, 2005.
11	Net Income per Common and Common Equivalent Share
31.1	Certification Pursuant to Rule 13a-14(a) Under the Securities Exchange Act
31.2	Certification Pursuant to Rule 13a-14(a) Under the Securities Exchange Act
32	Certification Pursuant to 18 U.S.C. 1350 and Rule 13a-14(b) Under the Securities Exchange Act of 1934

SIGNATURES

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date	August 12, 2005	HEMACARE CORPORATION (Registrant)
		/s/ JUDI IRVING Judi Irving, *Chief Executive Officer* /s/ ROBERT S. CHILTON Robert S. Chilton, *Chief Financial Officer*

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EXHIBIT INDEX

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