HEMACARE CORP /CA/
Form 10-Q
August 14, 2006

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, 2006

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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer x

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

As of August 1, 2006, 8,210,060 shares of Common Stock of the registrant were issued and outstanding.

HEMACARE CORPORATION AND SUBSIDIARIES

INDEX TO FORM 10-Q

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2006

PART 1 FINANCIAL INFORMATION

Item 1. **Financial Statements**

HEMACARE CORPORATION

CONSOLIDATED BALANCE SHEETS

	June 30, 2006 (Unaudited)	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 1,732,000	$ 2,612,000
Accounts receivable, net of allowance for doubtful accounts $79,000 in 2006 and $85,000 in 2005	3,992,000	3,927,000
Product inventories and supplies	1,214,000	675,000
Prepaid expenses	737,000	350,000
Other receivables	12,000	145,000
Total current assets	7,687,000	7,709,000
Plant and equipment, net of accumulated depreciation and amortization of $4,307,000 in 2006 and $3,945,000 in 2005	3,012,000	2,703,000
Other assets	285,000	134,000
	$ 10,984,000	$ 10,546,000
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	$ 1,734,000	$ 1,791,000
Accrued payroll and payroll taxes	1,201,000	1,389,000
Other accrued expenses	195,000	290,000
Current obligations under capital leases	47,000	81,000
Current obligations under notes payable		
Total current liabilities	3,177,000	3,551,000
Obligations under capital leases, net of current portion		7,000
Commitments and contingencies		
Shareholders equity:		
Common stock, no par value 20,000,000 shares authorized, 8,210,060 and 8,196,060 shares issued and outstanding in 2006 and 2005	14,070,000	13,696,000
Accumulated deficit	(6,263,000)	(6,708,000)
Total shareholders equity	7,807,000	6,988,000
	$ 10,984,000	$ 10,546,000

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

1

HEMACARE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three months ended June 30, 2006	Three months ended June 30, 2005	Six months ended June 30, 2006	Six months ended June 30, 2005
Revenues:				
Blood products	$ 6,799,000	$ 5,862,000	$ 13,166,000	$ 11,480,000
Blood services	1,633,000	1,659,000	3,454,000	3,124,000
Total revenues	8,432,000	7,521,000	16,620,000	14,604,000
Operating costs and expenses:				
Blood products	5,570,000	4,547,000	10,758,000	8,968,000
Blood services	1,372,000	1,208,000	2,724,000	2,405,000
Total operating costs and expenses	6,942,000	5,755,000	13,482,000	11,373,000
Gross profit	1,490,000	1,766,000	3,138,000	3,231,000
General and administrative expenses	1,121,000	1,321,000	2,667,000	2,510,000
Income before income taxes	369,000	445,000	471,000	721,000
Provision for income taxes	9,000	5,000	26,000	5,000
Net income	$ 360,000	$ 440,000	$ 445,000	$ 716,000
Basic earnings per share	$ 0.04	$ 0.05	$ 0.05	$ 0.09
Diluted earnings per share	$ 0.04	$ 0.05	$ 0.05	$ 0.08
Weighted average shares outstanding basic	8,199,000	8,106,000	8,122,000	8,090,000
Weighted average shares outstanding diluted	9,325,000	8,806,000	9,140,000	8,807,000

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

2

HEMACARE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six months ended June 30, 2006	2005
Cash flows from operating activities:		
Net income	$ 445,000	$ 716,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Recovery of bad debts	(6,000)	(13,000)
Depreciation and amortization	371,000	332,000
Loss (gain) on disposal of assets	5,000	(3,000)
Share-based compensation expense	362,000	
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(59,000)	325,000
Increase in inventories, supplies and prepaid expenses	(926,000)	(424,000)
Decrease (increase) in other receivables	133,000	(15,000)
Increase in other assets	(151,000)	(11,000)
Decrease in accounts payable, accrued expenses and other liabilities	(340,000)	(260,000)
Net cash (used in) provided by operating activities	(166,000)	647,000
Cash flows from investing activities:		
Proceeds from sale of plant and equipment	3,000	13,000
Purchases of plant and equipment	(689,000)	(128,000)
Net cash used in investing activities	(686,000)	(115,000)
Cash flows from financing activities:		
Proceeds from the exercise of stock options	13,000	19,000
Proceeds from sale of common stock		132,000
Principal payments on debt and capitalized leases	(41,000)	(139,000)
Net cash (used in) provided by financing activities	(28,000)	12,000
(Decrease) increase in cash and cash equivalents	(880,000)	544,000
Cash and cash equivalents at beginning of period	2,612,000	2,082,000
Cash and cash equivalents at end of period	$ 1,732,000	$ 2,626,000
Supplemental disclosure:		
Interest paid	$ 3,000	$ 33,000
Income taxes paid (refunded)	$ 47,000	$ (17,000)

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

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, 2006 and 2005 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, 2006, the results of its operations for the three and six months ended June 30, 2006 and 2005, and its cash flows for the six months ended June 30, 2006 and 2005 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, 2005, as filed with the Securities and Exchange Commission on March 21, 2006 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, 2006 are not necessarily indicative of the consolidated results of operations to be expected for the full fiscal year ending December 31, 2006. 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.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 123R, Share-based Payment: An amendment of FASB Statements No. 123 and 95 (SFAS 123R), in the first quarter of fiscal year 2006, the Company started to recognize compensation expense related to stock options granted to employees based on: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant date fair value estimated in accordance with SFAS No 123, Accounting for Stock-Based Compensation (SFAS 123), and (b) compensation cost for all share-based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R.

The Company s assessment of the estimated fair value of the stock options granted is affected by the price of the Company s stock, as well as assumptions regarding a number of complex and subjective variables and the related tax impact. Management utilized the Black-Scholes model to estimate the fair value of stock options granted. Generally, the calculation of the fair value for options granted under SFAS 123R is similar to the calculation of fair value under SFAS 123, with the exception of the treatment of forfeitures.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. This model also requires the input of highly subjective assumptions including:

(a) The expected volatility of the common stock price, which was determined based on historical volatility of the Company s common stock;

(b) Expected dividends, which are not anticipated; and

(c) Expected life of the stock option, which is estimated based on the historical stock option exercise behavior of employees.

In the future, management may elect to use different assumptions under the Black-Scholes valuation model or a different valuation model, which could result in a significantly different impact on net income or loss.

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, 2006 and December 31, 2005, the Company had uninsured cash and cash equivalents of $1,525,000 and $2,401,000, respectively.

APPLICATION OF NEW ACCOUNTING STANDARDS

In July 2006, the FASB issued FASB Interpretation Number 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*, (FIN48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken in a tax return. The Company must determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets the more-likely-than-not recognition threshold, the position is measured to determine the amount of benefit to recognize in the financial statements. FIN 48 applies to all tax positions related to income taxes subject to FASB Statement No. 109, *Accounting for Income Taxes*. The interpretation clearly scopes out income tax positions related to FASB Statement No. 5, *Accounting for Contingencies*. The Company will adopt the provisions of this statement beginning in the first quarter of 2007. The cumulative effect of applying the provisions of FIN 48 will be reported as an adjustment to the opening balance of retained earnings on January 1, 2007. The Company does not anticipate that the adoption of this statement will have a material effect on our financial position or results of operations.

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 (Comerica). This credit facility is scheduled to terminate June 30, 2007, and limits the amount the Company may borrow to 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, 2006, the rate associated with this credit facility was 8.00%. 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, 2006, the Company had no net borrowing on this line of credit, and the Company had unused availability of $2 million.

The Comerica credit facility 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 prohibit the payment of dividends. As of June 30, 2006, the Company was in full compliance with all of the financial covenants. During the first six months of 2006, the Company did not incur any interest expense associated with the Comerica credit facility.

The Company also has a capital equipment lease with GE Capital used to finance the acquisition of vehicles. As of June 30, 2006, the balance outstanding on this lease was $47,000, all of which is included in current obligations. This lease is scheduled to terminate in January 2007, and has a fixed interest rate of 8.0%.

Finally, the Company had a capital equipment lease with Toshiba Financial Services associated with the acquisition of photocopier equipment. During the second quarter of 2006, the Company paid the remaining balance of this obligation of $1,000.

Note 3 Shareholders Equity

Through the end of fiscal 2005, the Company measured compensation expense for stock-based incentive programs utilizing the intrinsic value method prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. Under this method, the Company did not record compensation expense when stock options were granted to eligible participants as long as the exercise price was not less than the fair market value of the stock when the option was granted. In accordance with SFAS 123R, the Company disclosed the pro forma net income per share as if the fair value-based method had been applied in measuring compensation expense for share-based incentive awards. No share-based compensation cost was recognized in the Condensed Consolidated Statement of Income for the three month or six month period ended June 30, 2005 for options granted under the Company s 1996 Stock Incentive Plan, as all unvested options granted had an exercise price equal to the market value of the underlying common stock on the date of grant.

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123R. This statement requires that the cost resulting from all share-based payment transactions be recognized in the Company s consolidated financial statements. In addition, in March 2005 the Securities and Exchange Commission (SEC) released SEC Staff Accounting Bulletin No. 107, Share-Based Payment (SAB 107). SAB 107 provides the SEC s staff s position regarding the application of SFAS 123R and certain SEC rules and regulations, and also provides the staff s views regarding the valuation of share-based payment arrangements for public companies. Generally, the approach in SFAS 123R is similar to the approach described in SFAS 123. However, SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the statement of operations based on their fair values. Pro forma disclosure of fair value recognition, as prescribed under SFAS 123, is no longer an alternative.

In 2006, the Company adopted the fair value recognition provisions of SFAS 123R utilizing the modified prospective transition method, as prescribed by SFAS 123R. Under that transition method, compensation cost recognized during the three months and six months ended June 30, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of March 31, 2006, and December 31, 2005 respectively based on the grant date fair value estimated in accordance with SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to March 31, 2006, and December 31, 2005 respectively, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Under the modified prospective transition method, results for the prior periods have not been restated.

For the three months and six months ended June 30, 2006, the Company recognized non-cash share-based compensation costs of $52,000 and $361,000, respectively, as a result of the adoption of SFAS 123R, lowering income before taxes and net income by these amounts. In addition, basic earnings per share for the three months and six months ended June 30, 2006 are $.01 and $.05 lower, respectively, than if the Company did not account for share-based compensation per SFAS 123R. Diluted earnings per share for the second quarter of 2006 are not affected by SFAS 123R share-based compensation; however, for the six months ended on June 30, 2006, diluted earnings per share are $.04 lower than if the company did not apply SFAS 123R.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123R to options granted under the Company s stock option plans in all periods presented. The Company did not recognize any compensation expense related to the issuance of stock options in 2005. The effect of applying SFAS 123R resulted in lowering income from continuing operations, income before taxes, net income and basic and diluted earnings per share are as follows:

	Three months ended June 30,		**Six months ended June 30,**	
	2006	**2005**	**2006**	**2005**
Net income, as reported	$ 360,000	$ 440,000	$ 445,000	$ 716,000
Less: Total share-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects	N/A	19,000	N/A	152,000
Pro forma net income	$ 360,000	$ 421,000	$ 445,000	$ 564,000
Net income per share basic				
As reported	$ 0.04	$ 0.05	$ 0.05	$ 0.09
Pro forma	$ 0.04	$ 0.05	$ 0.05	$ 0.07
Net income per share diluted				
As reported	$ 0.04	$ 0.05	$ 0.05	$ 0.08
Pro forma	$ 0.04	$ 0.05	$ 0.05	$ 0.06
Shares used in computing net income per share				
Basic	8,199,000	8,106,000	8,122,000	8,090,000
Diluted	9,325,000	8,806,000	9,140,000	8,807,000

The following summarizes the activity of the Company s stock options for the six months ended June 30, 2006:

	Shares	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term**
Number of shares under option:			
Outstanding at January 1, 2006	1,501,000	$ 0.99	
Granted	365,000	2.41	
Exercised	(14,000)	.90	
Canceled or expired	(16,000)	.80	
Outstanding at June 30, 2006	1,836,000	$ 1.27	4.5
Exercisable at June 30, 2006	1,374,000	$ 1.12	4.5

The following summarizes the activity of the Company s stock options that have not vested for the six months ended June 30, 2006.

	Shares	**Weighted Average Fair Value**
Nonvested at January 1, 2006	378,000	$ .93
Granted	365,000	2.41
Vested	(281,000)	1.56
Nonvested at June 30, 2006	462,000	$ 1.71

As of June 30, 2006, there was $527,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under existing stock option plans. This cost is expected to be recognized over a weighted-average period of 3.25 years. The total measurement fair value of shares vested during the six months ended June 30, 2006 was $440,000.

The Black-Scholes option pricing model is used by the Company to determine the weighted average fair value of options. The fair value of options at date of grant and the assumptions utilized to determine such values are indicated in the following table:

	Three months ended June 30, 2006		2005		Six Months Ended June 30, 2006		2005	
Weighted average fair value at date of grant for options granted during the period	$ 63,000		$ 55,000		$ 879,000		$ 480,000	
Risk-free interest rates	5.0	%	4.0	%	5.0	%	4.0	%
Expected stock price volatility	95.3	%	108.4	%	95.3	%	108.4	%
Expected dividend yield	0.0	%	0.0	%	0.0	%	0.0	%

On July 19, 2006 the Company s 1996 Stock Option Plan expired. At the Company s annual meeting of shareholders held on May 24, 2006, the shareholders approved the 2006 Equity Incentive Plan (the Plan). The Plan is to encourage ownership in the Company be key personnel whose long-term service is considered essential to the Company s continued progress, thereby linking these employees directly to stockholder interests through increased stock ownership. A total of 1,200,000 shares of the Company s Common Stock will be reserved for issuance under the Plan. Awards may be granted to any employee, director or consultant, or those of the Company s affiliates. As of August 1, 2006, no awards had been granted under the Plan.

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, 2006	2005	Six months ended June 30, 2006	2005
Net income	$ 360,000	$ 440,000	$ 445,000	$ 716,000
Weighted average shares outstanding	8,199,000	8,106,000	8,122,000	8,090,000
Net effect of dilutive options and warrants	1,126,000	700,000	1,018,000	717,000
Diluted shares outstanding	9,325,000	8,806,000	9,140,000	8,807,000

Options and warrants outstanding of 0 shares and 490,000 shares of common stock for the three and six months ended June 30, 2006, respectively, have been excluded from the above calculation because their effect would have been anti-dilutive.

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.

Note 5 Provision for Income Taxes

The Company has substantial net operating losses from prior periods that will be available in 2006 to eliminate most of any potential federal tax liability. The Company has recognized income in each of the

8

last eleven 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.

As a result of federal alternative minimum taxes and other state taxes, the Company estimates that $9,000 in taxes has been incurred as a result of reportable income during the second quarter of 2006. As described in Note 3, in 2006, the Company adopted the fair value recognition provisions of SFAS 123R pertaining to share-based compensation transactions. This adoption creates temporary differences between GAAP based net income and tax based net income because the compensation deduction permitted under SFAS 123R is not deductible for taxes. When option holders exercise their rights to purchase the Company s shares, the Company is entitled to take a tax deduction, eliminating the temporary difference created when the option rights vested.

The Company recognized $52,000 in compensation expense related to SFAS 123R in the second quarter of 2006. As a result of the temporary difference created, the Company s deferred tax asset balance increased $8,000. Since the Company maintains a 100% valuation reserve for its deferred tax reserve, none of the increase in deferred taxes is reflected in the income statement.

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.

There were no intersegment revenues for either the three month or six month period ended June 30, 2006 or ended June 30, 2005.

Note 7 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. 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 the Company. 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, and others, in the United States. The blood products distributed consist of those produced by the Company and purchased from other suppliers. Additionally, the Company provides blood related services, principally therapeutic apheresis procedures, and stem cell collection to patients with a variety of disorders. Blood related services are provided on an in-patient and out-patient basis under contract, as an outside purchased service.

The Company has operated in Southern California since 1979. In 1998, the Company expanded operations, through the acquisition of a similar business, into portions of the eastern U.S. In 2003, new management, following a comprehensive evaluation of the Company s operations, decided 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.

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.

Results of Operations

Three months ended June 30, 2006 compared to the three months ended June 30, 2005

Overview

The Company generated revenue for the second quarter of 2006 of $8,432,000, an increase of $911,000, or 12.1%, compared to the same period of 2005. Blood products revenue increased $937,000, or 16.0%, as a result of increased blood product sales in California, and increases in selected product prices from the prior year. Blood services revenue decreased $26,000, or 1.6%, mostly as a result of a 2.6% decrease in the number of procedures performed.

Gross profit in the second quarter of 2006 decreased $276,000, or 15.6%, compared to the second quarter of 2005. The decrease is attributable to an increase in compensation cost associated with the Company s Maine operations, an increase in the cost of albumin, which is used principally by the Company s Blood Services business segment and an increase in regulatory salary compliance costs.

The Company generated $360,000 of net income for the second quarter of 2006, representing an $80,000, or 18.2%, decrease from the same period in 2005. The decrease is primarily attributable to the decrease in gross profit as described above. In addition, the recognition of $52,000 of non-cash share-based compensation expense in the second quarter of 2006 contributed to the decrease in net income for the quarter compared to the same quarter in 2005.

Blood Products

For the three months ended June 30, 2006, blood product revenues increased $937,000, or 16.0%, compared with the same quarter of 2005. This increase is attributable to an increase in sales volume of blood products in California, an increase in the prices charged for selected products over the prior year and record levels of sales to research-related customers.

For the three months ended June 30, 2006, gross profit for the blood products segment decreased $86,000, or 6.5%, to $1,229,000 from $1,315,000 generated in second quarter of 2005. This decrease is due to an increase in staff compensation expense in the Company s Maine blood products operations and increased regulatory compliance salary expenses. The gross profit percentage for blood products decreased to 18.1% in the second quarter of 2006, from 22.4% for the same quarter of 2005.

Blood Services

Revenues from blood services decreased $26,000, or 1.6%, to $1,633,000 in the second quarter of 2006 from $1,659,000 generated in the same period of 2005. The decrease was mainly due to a 2.6% decrease in the number of therapeutic apheresis procedures performed during the quarter compared to the same quarter in 2005.

Gross profit for the blood services segment decreased $190,000, or 42.1%, from $451,000 in the second quarter of 2005 to $261,000 during the same period of 2006. For the quarter, this business segment produced a gross profit percentage of 16.0%, compared with 27.2% for the same quarter in 2005. This decrease is primarily the result of a significant increase in the cost of albumin, which is a supply used in many therapeutic apheresis procedures, and a 2.6% decrease in procedure volumes.

General and Administrative Expenses

General and administrative expenses decreased $200,000, or 15.1%, to $1,121,000 in the second quarter of 2006 from $1,321,000 in the same period of 2005. This decrease was the result of i) a $123,000 decrease in cash-based employee compensation and benefit expense, ii) a $110,000 decrease in the cost of outside services, iii) a $18,000 decrease in bad debt expense, and iv) a $14,000 decrease in interest expense. The decrease in employee compensation is mostly the result of lower accrued bonuses and lower costs associated with the Company s 401(k) plan. The decrease in outside service costs is the result of reduced utilization of consultants and other outside professionals to assist management with various projects, and filling several open positions since the second quarter of 2005, which minimized the use of outside temporary resources. Bad debt expense decreased in the quarter due to a reduction in the reserve for doubtful accounts as a result of a reduction in the overall age of uncollected customer receivables. Finally, interest expense decreased as a result of the substantial reduction in the Company s utilization of debt since the second quarter of 2005.

The decreases in general and administrative costs were partially offset by a $42,000 increase in insurance costs, and a $20,000 net increase in non-cash share-based compensation. On May 1, 2006, the Company renewed all of its general and professional liability insurance policies, which resulted in an overall premium increase compared with the second quarter of 2005. The increase in share-based compensation reflects recognition of $42,000 in non-cash share-based compensation expense in the second quarter of 2006 associated with options issued under the Company s 1996 Stock Incentive Plan. In the second quarter of 2005, however, the Company recognized $22,000 in share-based compensation as a result of the purchase of 80,000 shares of the Company s stock through the Employee Stock Purchase Plan. The net impact of these two items was an overall increase in non-cash share-based compensation of $20,000.

Income Taxes

The Company has sufficient net operating loss carryforwards to avoid most federal income tax expense for the second quarter of 2006. However, management anticipates that the Company will be subject to federal alternative minimum tax in 2006. 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 2006, the Company recorded $9,000 to the provision for income taxes based on these estimates. In the first quarter of 2006, the Company adopted the fair value recognition provisions of SFAS 123R pertaining to share-based compensation transactions. This adoption creates temporary differences between GAAP based net income and tax based net income because the compensation deduction permitted under SFAS 123R is not deductible for taxes. When option holders exercise their rights to purchase the Company s shares, the Company is entitled to take a tax deduction, eliminating the temporary difference created when the option rights vested.

The Company recognized $52,000 in compensation expense related to SFAS 123R in the second quarter of 2006. As a result of the temporary difference created, the Company s deferred tax asset balance increased $8,000. Since the Company maintains a 100% valuation reserve for its deferred tax reserve, none of the increase in deferred taxes is reflected in the income statement.

Six months ended June 30, 2006 compared to the six months ended June 30, 2005

Overview

The Company reported revenue for the six months ended June 30, 2006 of $16,620,000, a $2,016,000, or 13.8%, increase, from $14,604,000 generated during the same period in 2005. Blood products revenue increased $1,686,000, or 14.7%, as a result of increased sales in the Company s California market. Blood services revenue increased $330,000, or 10.6%, mostly as a result of an increase in the number of procedures performed.

Gross profit for the first six months of 2006 decreased $93,000, or 2.9%, compared with the first six months of 2005, mostly as a result of higher staff compensation expenses at the Company s Maine operations, and for regulatory compliance.

General and administrative expenses increased $157,000, or 6.3%, due to the Company s adoption of SFAS 123R in 2006.

Net income for the period decreased $271,000, or 37.8%, to $445,000, from $716,000 in the first six months of 2005. This decrease is attributable to $361,000 in non-cash share-based compensation expense recognized during the first six months of 2006. No such expense was recognized in the first six months of 2005 per the modified prospective transition method provided in SFAS 123R.

Blood Products

For the six months ended June 30, 2006, revenues for this business segment increased $1,686,000, or 14.7%, compared to the same period of 2005. The increase in revenue is directly attributable to higher sales volumes at the Company s California operations, as well as year over year increases in selected product pricing.

For the six months ended June 30, 2006, gross profit for the blood products segment decreased $104,000, or 4.1%, compared with the same period of 2005. The gross profit percentage for the blood products segment decreased to 18.3%, from 21.9% recorded during the first six months of 2005. The decline is attributable to an increase in staff compensation expense at the Company s Maine operations.

Blood Services

Revenues from blood services increased $330,000, or 10.6%, to $3,454,000 in the first six months of 2006 from $3,124,000 in the same period of 2005. The increase was mainly due to a 6.5% increase in the number of therapeutic apheresis procedures performed.

Gross profit for the blood services segment increased $11,000, or 1.5%, to $730,000 in the first six months of 2006 from $719,000 during the same period in 2005, reflecting higher procedure volumes. For the first six months of 2006, this business segment produced a gross profit percentage of 21.1%, compared with 23% for the same period in 2005. The decrease is primarily the result of a significant increase in the cost of albumin, which is used in many therapeutic apheresis procedures.

General and Administrative Expenses

General and administrative expenses increased by $157,000, or 6.3%, to $2,667,000 in the first six months of 2006 from $2,510,000 in the same period of 2005. This increase was primarily due to the Company s adoption of SFAS 123R in 2006. As a result, the Company recognized $320,000 in non-cash share-based compensation expense in this expense category in the first six months of 2006 associated with options issued under the Company s 1996 Stock Incentive Plan. In addition, liability insurance expense increased $77,000 as a result of higher insurance premiums upon renewal of the Company s insurance policies during the second quarter of 2006. The increases in general and administrative expenses in the first six months of 2006 were offset by a $185,000 reduction in the cost for consultants, outside services and temporary personnel, and a $65,000 decrease in staff compensation and benefits expenses. The decrease in outside services was the result of the completion of several projects that required outside assistance during the first six months of 2005, and filling several open positions since the first six months of 2005, which minimized the use of outside temporary resources in the first six months of 2006. The reduction in compensation and benefits expenses is mostly attributable to lower bonus accrual, and reduced costs associated with the Company s 401(k) plan.

Income Taxes

The Company has sufficient net operating loss carryforwards to avoid most federal income tax expense for the first six months of 2006. However, management anticipates that the Company will be subject to federal alternative minimum tax in 2006. 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 first six months of 2006, the Company recorded $26,000 to the provision for income taxes based on these estimates. In the first six months of 2006, the Company adopted the fair value recognition provisions of SFAS 123R pertaining to share-based compensation transactions. This adoption creates temporary differences between GAAP based net income and tax based net income because the compensation deduction permitted under SFAS 123R is not deductible for taxes. When option holders exercise their rights to purchase the Company s shares, the Company is entitled to take a tax deduction, eliminating the temporary difference created when the option rights vested.

The Company recognized $361,000 in compensation expense related to SFAS 123R in the first six months of 2006. As a result of the temporary difference created, the Company s deferred tax asset balance increased $93,000. Since the Company maintains a 100% valuation reserve for its deferred tax reserve, none of the increase in deferred taxes is reflected in the income statement.

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.

Accounting for Share-Based Incentive Programs

In accordance with SFAS 123R, in the second quarter of 2006 the Company recognized compensation expense related to stock options granted to employees based on: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of March 31, 2006, based on the grant date fair value estimated in accordance with SFAS No 123, adjusted for an estimated future forfeiture rate, and (b) compensation cost for all share-based payments granted subsequent to March 31, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R.

The Company s assessment of the estimated fair value of the stock options granted is affected by the price of the Company s stock, as well as assumptions regarding a number of complex and subjective variables and the related tax impact. Management utilized the Black-Scholes model to estimate the fair value of stock options granted. Generally, the calculation of the fair value for options granted under SFAS 123R is similar to the calculation of fair value under SFAS 123, with the exception of the treatment of forfeitures.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. This model also requires the input of highly subjective assumptions including:

(a) The expected volatility of the common stock price, which was determined based on historical volatility of the Company s common stock;

(b) Expected dividends, which are not anticipated; and

(c) Expected life of the stock option, which is estimated based on the historical stock option exercise behavior of employees.

In the future, management may elect to use different assumptions under the Black-Scholes valuation model or a different valuation model, which could result in a significantly different impact on net income or loss.

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, 2006, the Company s cash and cash equivalents were $1,732,000 and the Company had working capital of $4,510,000.

The Company, together with Coral Blood Services, Inc., a subsidiary, has a working capital line of credit with Comerica Bank (Comerica). This credit facility is scheduled to terminate June 30, 2007, and limits the amount the Company may borrow is to 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, 2006 the rate associated with this note was 8.0%. 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, 2006, the Company had no net borrowing on this line of credit, and the Company had unused availability of $2 million.

The Comerica credit facility 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 prohibit the payment of dividends. As of June 30, 2006 the Company was in full compliance with all of the financial covenants. During the second quarter of 2006, the Company did not incur any interest expense associated with the Comerica credit facility.

The Company also has a capital equipment lease with GE Capital used to finance the acquisition of vehicles. As of June 30, 2006, the balance outstanding on this lease was $47,000, all of which is included in current obligations. This lease is scheduled to terminate in January 2007, and has a fixed interest rate of 8.0%.

Finally, the Company had a capital equipment lease with Toshiba Financial Services associated with the acquisition of photocopier equipment. During the second quarter of 2006, the Company paid the remaining balance of this obligation of $1,000.

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	$ 5,614	$ 323	$ 1,353	$ 983	$ 2,955
Capitalized leases	47	47			
Totals	$ 5,661	$ 370	$ 1,353	$ 983	$ 2,955

For the three months ended on June 30, 2006, net cash used in operating activities was $166,000, compared to $647,000 of cash provided by operating activities for the three months ended June 30, 2005. The decrease of $813,000 in cash provided between the two periods is primarily due to an increase in cash used for inventories, supplies and prepaid expenses of $926,000, compared to an increase of $424,000 for this category in 2005. This increase is associated with the purchase of albumin to support the Company s blood services segment. In addition, cash used in accounts receivables increased $59,000 in the first six months of 2006, compared to $325,000 of cash provided by accounts receivables for the first six months of 2005. As of June 30, 2006, the days sales outstanding were 43 days, compared to 41 days outstanding as of December 31, 2005. The Company has experienced some increase in the age of selected customer receivable balances during the first six months of 2006.

For the six months ended on June 30, 2006, net cash used in investing activities was $686,000, compared to $115,000 for the same period in 2005. The increase of $571,000 is primarily due to the Company s investments in vehicles, computer equipment and computer software. The Company did not make similar investments during the same period of 2005.

For the six months ended June 30, 2006, net cash used by financing activities was $28,000, compared to cash provided of $12,000 for the six months ended June 30, 2005. Most of the difference is due to a $98,000 reduction in the amount paid for debt obligations between the two periods since the Company has significantly reduced outstanding debt over the last year, and $132,000 received from the sale of common stock during the first six months of 2005. No similar stock transaction occurred during the first six months of 2006.

The Company entered into a lease to occupy a building located in Van Nuys, California for new corporate headquarters and to relocate the Company s blood processing and distribution operations from Sherman Oaks, California. The Company expects to incur approximately $1.5 million in capital expenditures for improvements and relocation costs. The Company 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 generated by operations 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 and facility improvements.

The Company s primary sources of liquidity include 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

The Company s 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. 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, many of which will be beyond the control of the Company. 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 or in other filings by the Company with the Securities and Exchange Commission. The Company does not undertake to update its forward-looking statements to reflect later events and circumstances or actual outcomes.

Steady or declining market prices could reduce profitability

The cost of collecting, processing and testing blood products has risen significantly in recent years and will likely continue to increase. These cost increases are related to new and improved testing procedures, increased regulatory requirements related to blood safety, and increased costs related to collecting and processing blood products. Competition and fixed price contracts may limit the Company s ability to maintain existing operating margins. Some competitors have greater resources than the Company to sustain periods of marginally profitable or unprofitable sales. Steady or declining market prices, and increased costs may reduce profitability and may have a material adverse effect on the business and results of operations.

Changes in demand for blood products could affect profitability

The Company s operations are structured to produce particular blood products based on customers existing demand, and perceived potential changes in demand, for these products. Sudden or unexpected changes in demand for 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 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 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.

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

Competition within the blood services and blood products industries is constantly changing. Recent consolidations of blood services providers has changed the competitive environment for the Company s blood services segment. Competition for customers and trained apheresis nurses is increasing. This has caused the Company to incur significant recruitment costs to replace nurses, dramatically increase nurses compensation and incur higher marketing related expenses in order to attract and retain customers. In addition, consolidations and affiliations within the hospital industry have changed the market for the blood products segment. The newly consolidated or affiliated hospitals have started to negotiate with the Company as a group, and therefore exert greater price pressure on the Company. These changes may have a negative impact on the Company s future revenue, and may negatively impact future profitability.

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

The Company is highly dependent upon obtaining the services of qualified professionals. In particular, the Company s operations depend on the services of registered nurses, medical technologists, regulatory and quality assurance professionals, and others with knowledge of the blood industry. Nationwide, the demand for these professionals exceeds the supply and competition for their services is strong. If the Company is unable to attract and retain a staff of qualified professionals, operations may be adversely affected.

Industry regulations could impact operations

The business of collecting, processing and distributing blood products is 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 January 2006 the Food and Drug Administration (FDA) performed an inspection of the Company s California operations. On May 5, 2006, the Company received a warning letter from the FDA pertaining to specific observations during the inspection. The Company has responded and implemented an action plan to address each issue.

State and federal laws include anti-kickback and self-referral prohibitions and other regulations that affect the shipping of blood products and 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; however, the possibility cannot be eliminated that interpretations of existing laws and regulations will result in findings 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

Decrease in reimbursement rates may affect profitability

Reimbursement rates for blood products and services provided to Medicaid, Medicare and commercial patients, impact the fees that the Company is able to negotiate with hospitals. In addition, to the degree that the Company s hospital customers receive lower reimbursement for the products and services provided by the Company, these customers may reduce their demand for these goods and services, and adversely affect the Company s revenue. If the Company is unable to increase prices for goods and services, the Company s profitability may be adversely affected.

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.

Not-For-Profit status gives advantages to competitors

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.

Reliance on relatively few vendors for significant supplies and services could affect the Company s ability to operate

The Company currently relies on a relatively small number of vendors to supply important supplies and services. Significant price increases, or disruptions in the ability of these vendors to provide products and services, may force the Company to find alternative vendors. Alternative vendors may not be available, or may not provide their products and services at favorable prices. If the Company cannot obtain the products and services it currently uses, or alternatives at reasonable prices, the Company s ability to produce products and provide services may be severely impacted and result in a reduction of revenue and profitability.

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 seeking to enhance efficiencies, and this consolidation is expected to continue. 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 or alternative treatments could jeopardize business

As a result of the risks posed by blood-borne diseases, many companies are currently seeking to develop alternative treatments for blood product transfusions or synthetic substitutes for human blood products. HemaCare s business consists of collecting, processing and distributing human blood products and providing blood related therapeutic services. The introduction and acceptance in the market of alternative treatments or 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 $1,655,000 in net income in 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.

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 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.

Ability to attract, retain and motivate management and other skilled employees

The Company s success depends significantly on the continued services of key management and skilled personnel. Competition for qualified personnel is intense and there are a limited number of people with knowledge of, and experience in, the blood product and blood service industries. The Company does not have employment agreements with most key employees, nor maintain life insurance policies on them. The loss of key personnel, especially without advance notice, or the Company s inability to hire or retain qualified personnel, could have a material adverse affect on revenue and on the Company s ability to maintain a competitive advantage. The Company cannot guarantee that it can retain key management and skilled personnel, or that it will be able to attract, assimilate and retain other highly qualified personnel in the future.

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 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.

Environmental risks could cause the 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. Delays or stoppages in the 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.

Evaluation and consideration of strategic alternatives, and other significant projects, may distract management from reacting appropriately to business challenges and lead to reduced profitability

As a publicly traded Company, management must constantly evaluate and consider new strategic alternatives, and other significant projects, in an attempt to maximize shareholder value. The Company does not possess a large management team that can both consider strategic alternatives and manage daily operations. Therefore, management distractions associated with the evaluation and consideration of strategic alternatives, could prevent management from dedicating appropriate time to immediate business challenges or other significant business decisions. This may cause a material adverse impact on the future profitability of the Company.

Strategy to acquire companies may result in unsuitable acquisitions or failure to successfully integrate acquired companies, which could lead to reduced profitability

The Company may embark on a growth strategy through acquisitions of companies or operations that compliment existing product lines, customers or other capabilities. The Company may be unsuccessful in identifying suitable acquisition candidates, or may be unable to consummate a desired acquisition. To the extent any future acquisitions are completed, the Company may be unsuccessful in integrating acquired companies or their operations, or if integration is more difficult than anticipated, the Company may experience disruptions that could have a material adverse impact on future profitability. Some of the risks that may affect the Company s ability to integrate, or realize any anticipated benefits from, acquisitions include:

- unexpected losses of key employees or customer of the acquired company;
- difficulties integrating the acquired company s standards, processes, procedures and controls;
- difficulties coordinating new product and process development;
- difficulties hiring additional management and other critical personnel;

- difficulties increasing the scope, geographic diversity and complexity of the Company s operations;
- difficulties consolidating facilities, transferring processes and know-how;
- difficulties reducing costs of the acquired company s business;
- diversion of management s attention from the management of the Company; and
- adverse effects on existing business relationships with customers.

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 the Company s 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.

Quarterly revenue and operating results may fluctuate in future periods, and the Company may fail to meet investor expectations

The Company s quarterly revenue and operating results have fluctuated significantly in the past, and are likely to continue to do so in the future due to a number of factors, many of which are not within the Company s control. If quarterly revenue or operating results fall below the expectations of investors, the price of the Company s common stock could decline significantly. Factors that might cause quarterly fluctuations in revenue and operating results include the following:

- changes in demand for the Company s products and services, and the ability to attain the required resources to satisfy customer demand;
- ability to develop, introduce, market and gain market acceptance of new products or services in a timely manner;
- ability to manage inventories, accounts receivable and cash flows;
- ability to control costs; and
- ability to attract qualified blood donors.

The amount of expenses incurred depends, in part, on expectation regarding future revenue. In addition, since many expenses are fixed in the short term, the Company cannot significantly reduce expenses if there is a decline in revenue to avoid losses.

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 the Company s 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 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, 2007. 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, 2008.

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.

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 $47,000 of debt, all of which is in the form of capitalized leases with fixed interest rates. As of June 30, 2006, 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 1A. Risk Factors

The risk factors disclosed in the Risk Factors section of the Company s Annual Report on Form 10-K for the year ended December 31, 2005 have not materially changed other than as set forth below.

The following risk factors were not part of the Risk Factors section of the Company s Annual Report on Form 10-K for the year ended December 31, 2005:

Strategy to acquire companies may result in unsuitable acquisitions or failure to successfully integrate acquired companies, which could lead to reduced profitability

The Company may embark on a growth strategy through acquisitions of companies or operations that compliment existing product lines, customers or other capabilities. The Company may be unsuccessful in identifying suitable acquisition candidates, or may be unable to consummate a desired acquisition. To the extent any future acquisitions are completed, the Company may be unsuccessful in integrating acquired companies or their operations, or if integration is more difficult than anticipated, we may experience disruptions that could have a material adverse impact on future profitability. Some of the risks that may affect the Company s ability to integrate, or realize any anticipated benefits from, acquisitions include:

- unexpected losses of key employees or customer of the acquired company;
- difficulties integrating the acquired company s standards, processes, procedures and controls;
- difficulties coordinating new product and process development;
- difficulties hiring additional management and other critical personnel;
- difficulties increasing the scope, geographic diversity and complexity of the Company s operations;
- difficulties consolidating facilities, transferring processes and know-how;
- difficulties reducing costs of the acquired company s business;
- diversion of management s attention from the management of the Company; and
- adverse effects on existing business relationships with customers.

The following risk factors were part of the Risk Factors section of the Company s Annual Report on Form 10-K for the year ended December 31, 2005, but have been updated to reflect recent events:

Industry regulations could impact operations

The business of collecting, processing and distributing blood products is 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 January 2006 the Food and Drug Administration (FDA) performed an inspection of the Company s California operations. On May 5, 2006, the Company

25

received a warning letter from the FDA pertaining to specific observations during the inspection. The Company has responded and implemented an action plan to address each issue.

State and federal laws include anti-kickback and self-referral prohibitions and other regulations that affect the shipping of blood products and 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; however, the possibility cannot be eliminated that interpretations of existing laws and regulations will result in findings 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

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, 2006.

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	6,184,287	N/A	488,450
	Judi Irving	6,184,087	N/A	488,650
	Teresa S. Sligh, M. D.	6,626,269	N/A	46,468
	Terry Van Der Tuuk	6,626,094	N/A	46,643
	Steven B. Gerber, M.D.	6,626,069	N/A	46,668
2.	*Approval of 2006 Equity Incentive Plan*	2,399,391	860,228	3,413,118
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, 2006*	6,659,885	5,010	7,842

Item 5. Other Information

The proxy materials for the 2006 annual meeting of shareholders held on May 24, 2006 were mailed to shareholders of the Company on April 21, 2006. Under certain circumstances, shareholders are entitled to present proposals at stockholder meetings. Any such proposal to be included in the proxy statement for the 2007 annual meeting of shareholders must be received at the Company s executive offices at 21101 Oxnard Street, Woodland Hills, CA, 91367, addressed to the attention of the Corporate Secretary by February 27, 2007 in a form that complies with applicable regulations. The Securities and Exchange Commission s rules provide that, in the event a stockholder proposal is not submitted to the Company prior to February 27, 2007, the proxies solicited by the Board for the 2007 annual meeting of shareholders will confer authority on the holders of the proxy to vote the shares in accordance with their best judgment and discretion if the proposal is presented at the 2007 annual meeting of stockholder without any discussion of the proposal in the proxy statement for such meeting.

If the date of the 2007 annual meeting of shareholders is advanced or delayed more than 30 days from the date of the 2006 annual meeting, stockholder proposals intended to be included in the proxy statement for the 2007 annual meeting must be received by the Company within a reasonable time before the Company begins to print and mail the proxy statement for the 2007 annual meeting. Upon any determination that the date of the 2007 annual meeting will be advanced or delayed by more than 30 days from the date of the 2006 annual meeting, the Company will disclose the change in the earliest practicable Quarterly Report on Form 10-Q.

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 Indemnification Agreement between HemaCare Corporation and Judi Irving, President and Chief Executive Officer dated July 5, 2006, incorporated by reference to Exhibit 99.1 to Form 8-K of the Registrant filed on July 6, 2006.

10.2 Indemnification Agreement between HemaCare Corporation and Robert Chilton, Executive Vice President and Chief Financial Officer dated July 5, 2006, incorporated by reference to Exhibit 99.1 to Form 8-K of the Registrant filed on July 6, 2006

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

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 14, 2006	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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