LUCILLE FARMS INC
Form 10-Q
August 15, 2005

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13
OR 15 (d) OF THE SECURITITES AND EXCHANGE
ACT OF 1934

For the Quarterly Period Ended:
June 30, 2005
Commission File Number 1-12506

LUCILLE FARMS, INC.
(Exact Name of Registrant as Specified in its charter)

Delaware	13-2963923
(State or other Jurisdiction of Incorporation)	(I.R.S. Employer Identification number)

12 Jonergin Drive, P.O. Box 125
Swanton, Vermont 05488
(Address of Principal Executive Offices) (zip code)

(Registrant's Telephone Number, Including Area Code)
(802)868-7301

Former name, former address and former fiscal year, if changed since last report. N/A

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 and 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 [ ]

The number of shares of Registrant's common stock, par value $.001 per share, outstanding as of August 2, 2005 was 3,353,937.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LUCILLE FARMS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
ASSETS

	JUNE 30, 2005	MARCH 31, 200
	(UNAUDITED)	
CURRENT ASSETS:		
Cash and cash equivalents	$ 212,000	$ 132,00
Accounts receivable, net of allowances of $67,000 at June 30, 2005 and at March 31, 2005	4,476,000	5,172,00
Inventories	2,087,000	2,739,00
Prepaid expenses and other current assets	735,000	621,00
Total current assets	7,510,000	8,664,00
PROPERTY, PLANT AND EQUIPMENT, NET	9,023,000	9,206,00
OTHER ASSETS:		
Deferred costs, net	619,000	637,00
Other	54,000	54,00
Total other assets	673,000	691,00
TOTAL ASSETS	$17,206,000	$18,561,00

See accompanying notes to consolidated financial statements

LUCILLE FARMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
LIABILITIES AND STOCKHOLDERS' EQUITY

	JUNE 30, 2005 (UNAUDITED)
CURRENT LIABILITES:	
Accounts payable	$ 4,879,000
Current portion of long-term debt	665,000
Accrued expenses	240,000
Total Current Liabilities	5,784,000
Long-term debt	12,258,000
TOTAL LIABILITIES	18,042,000
STOCKHOLDERS' EQUITY:	
Preferred stock, $ 0.001 per value, 250,000 shares authorized:	
583 shares Series B convertible issued and outstanding	1,000
Common stock, $ 0.001 par value, 25,000,000 shares authorized, 3,570,675 shares issued, 3,353,937 outstanding at June 30, 2005 and March 31, 2005	4,000
Additional paid in capital	8,548,000
Accumulated deficit	(9,077,000)
	(525,000)
Less: cost of 216,738 shares of treasury stock	(312,000)
Total Stockholders' Equity	(836,000)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 17,206,000

See accompanying notes to consolidated financial statements

LUCILLE FARMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

THREE MONTHS ENDED JUNE 30,

	2005
SALES	$ 10,889,000
COST OF SALES	10,580,000
GROSS PROFIT	309,000
OTHER EXPENSES:	
SELLING	283,000
GENERAL AND ADMINISTRATIVE	352,000
INTEREST EXPENSE	248,000
TOTAL OTHER EXPENSES	883,000
INCOME (LOSS) BEFORE INCOME TAXES	(574,000)
PROVISION FOR INCOME TAXES	--
NET INCOME (LOSS)	$ (574,000)
NET INCOME (LOSS) PER SHARE:	
BASIC:	
	$ (.17)
DILUTED:	$ (.17)
WEIGHTED AVERAGE SHARES OUTSTANDING USED TO COMPUTE NET INCOME (LOSS) PER SHARE	
BASIC:	3,353,937
DILUTED:	3,353,937

See accompanying notes to consolidated financial statements

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LUCILLE FARMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

Three Months Ended June 30,

	2005
Cash flows from operating activities:	
Net Income (Loss)	$ (574,000)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:	
Depreciation and amortization	247,000
Provision for doubtful accounts	--
(Increase) decrease in assets:	
Accounts receivable	696,000
Inventories	652,000
Prepaid expenses and other current assets	(114,000)
Other assets	--
Increase (decrease) in liabilities:	
Accounts payable	1,149,000
Accrued expenses	(422,000)
Net cash provided by operating activities	1,634,000
CASH FLOW FROM INVESTING ACTIVITIES:	
Purchase of property, plant and equipment	(36,000)
Net cash used in investing Activities	(36,000)
CASH FLOW FROM FINANCING ACTIVITIES:	
Proceeds from revolving credit loan-net	-0-
Principal Payments on long-term debt	(1,508,000)
Increase in Loan Costs	(10,000)
Net cash used in financing activities	(1,518,000)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	80,000
CASH AND CASH EQUIVALENTS-BEGINNING	132,000

CASH AND CASH EQUIVALENTS-ENDING	$ 212,000

See accompanying notes to consolidated financial statements

LUCILLE FARMS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A. CONSOLIDATED FINANCIAL STATEMENTS

The Consolidated Balance Sheet as of June 30, 2005 and the Consolidated Statements of Operations and Cash Flows for the three month periods ended June 30, 2005 and 2004 have been prepared by the Company without audit. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the financial position of Lucille Farms, Inc. and subsidiaries as of June 30, 2005, the results of its operations and its cash flows for the three months ended June 30, 2005 and 2004.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Although the Company believes that the disclosures are adequate to make the information presented not misleading, it is suggested that these financial statements be read in conjunction with the year-end financial statements and notes thereto for the fiscal year ended March 31, 2005 included in the Company's Annual Report on Form 10-K as filed with the SEC.

The accounting policies followed by the Company are set forth in the notes to the Company's consolidated financial statements as set forth in its Annual Report on Form 10-K as filed with the SEC.

GOING CONCERN

The financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. For the three months ended June 30, 2005, the Company has a loss from continuing operations of $574,000 and a deficiency in assets of $836,000. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the outcome of this uncertainty.

The Company has developed a business plan designed to improve gross margins and reduce its dependency on the spread allowed by the calculation of the milk price. The plan calls for various capital improvements that will significantly reduce the cost of producing cheese and change the type of whey produced by the Company to whey protein concentrate for human and animal consumption. The capital improvements needed to achieve the business plan will require an infusion of capital of approximately $8,000,000. Discussions are currently underway with St. Albans Cooperative, the Company's milk supplier, the Vermont Economic Development Authority, the Village of Swanton, Vermont, UPS Business Credit, LLC and LaSalle Business Credit, LLC to structure a financing package that would provide a portion of such financing as well as strengthen the

Company's balance sheet. Also, the Company is having conversations with a potential joint venture partner that would provide the necessary financing to modify the Company's whey facility. There can be no assurance that such a financing package or joint venture will be forthcoming.

B. RECENT ACCOUNTING PRONOUNCEMENTS

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs." This statement requires the allocation of fixed production overhead to inventory based on the normal capacity of the production facilities and clarifies that abnormal amounts of idle facility expense, freight, handling costs and wasted materials should be recognized as period expense. The Statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is evaluating the impact of this Statement but does not expect it to have a significant effect on financial position or results of operations.

In December 2004, the FASB issued SFAS 123R, "Share Based Payment." SFAS 123R is a revision to SFAS 123 and supersedes APB 25, "Accounting for Stock Issued to Employees," and amends SFAS 95, "Statement of Cash Flows." This statement requires a public entity to expense the cost of employee services received in exchange for an award of equity instruments. This statement also provides guidance on valuing and expensing these awards, as well as disclosure requirements of these equity arrangements. The initial effective date for SFAS 123R was the first interim reporting period set to begin after June 15, 2005. On April 14, 2005 the SEC deferred the effective date six months therefore Lucille Farms, Inc. must comply with the provision of SFAS 123R in the third quarter of fiscal year 3/30/06. SFAS 123R permits public companies to choose between the following two adoption methods:

1. A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123R for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date, or

2. A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption Lucille currently accounts for share-based payments to employees using APB 25's intrinsic value method and, as such, recognizes no compensation expense for employee stock options. The impact of the adoption of SFAS 123R on Lucille cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. There would have been no material impact on reported results of operations and earnings per share had the Company applied the fair value provisions of SFAS 123 to share-based payments.

The adoption of SFAS 123R's fair value method may have an impact, possibly material, on Lucille's future results of operations but no material impact on overall financial position. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation expense, if any, to be reported as financing cash flow, rather than as operating cash flow as required under current literature. This requirement may reduce net operating cash flows

and increase net financing cash flows in the consolidated statement of cash flows of periods after adoption. Due to timing of the release of SFAS 123R and the choice between the two adoption methods, the Company is still analyzing the ultimate impact that this new pronouncement may have on its results of operations.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 153, "Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29". The guidance in APB Opinion No. 29, Accounting for Nonmonetary Transactions, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that Opinion, however, included exceptions to that principle. This statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productiveassets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commerical substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. Lucille intends to follow the interpretive guidance on accounting for exchanges for nonmonetary assets as set forth in SFAS No. 153.

On March 29, 2005, the Staff of the Securities and Exchange Commission (SEC or the Staff) issued Staff Accounting Bulletin No. 107, "Share-Based Payment" (SAB 107). Although not altering any conclusions reached in SFAS 123R, SAB 107 provides the views of the Staff regarding the interaction between SFAS 123R and certain SEC rules and regulations and, among other things, provide the Staff's views regarding the valuation of share-based payment arrangements for public companies. Lucille intends to follow the interpretative guidance on share-based payment set forth in SAB 107 during the Company's adoption of SFAS 123R.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, "Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3". This statement changes the requirements for the accounting for and the reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. Opinion 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. This statement requires retrospective application to prior periods' financial statements of changes in accounting principle. Lucille intends to follow the interpretive guidance on accounting for changes and error corrections as set forth in FASB No. 154 if applicable.

C. ACCOUNTING FOR STOCK BASED COMPENSATION

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for stock options and rewards. Accordingly, no compensation costs for stock options are included in operating results since all awards were made at exercise prices at or above their fair value on the dates of grants.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation- Transition and Disclosure", amending FASB Statement No. 123, "Accounting for Stock Based Compensation." This statement amends SFAS

No. 123 to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of SFAS No. 123 to require prominent disclosure about the effects on operating results of an entity's accounting policy decisions with respect to stock-based employee compensation. SFAS No. 148 also amends APB Opinion No. 128, "Interim Financial Reporting" to require disclosure about those effects in interim financial information.

The following table illustrates the effect on results of operations if the Company had applied the fair value recognition provisions of SFAS No. 123 for the three-month periods ended June 30, 2005 and 2004 (unaudited).

	3-Mos. ended	
	2005	200
Net Income as reported	$(574,000)	$ 4
Deduct: Total stock-based Employee Compensation determined under fair value method for stock options, net of tax	--	
Pro forma income applicable to common stockholders	$(574,000)	$ 4
Basic income per share, as reported	$ (0.17)	$
Basic income per share, pro forma	$ (0.17)	$
Diluted income per share, as reported	$ (0.17)	$
Diluted income per share, pro forma	$ (0.17)	$

D. INVENTORIES

Inventories are summarized as follows:

	June 30, 2005	March 31, 2005
Finished Goods	$1,327,000	$2,244,000
Raw Materials	361,000	217,000
Supplies and Packaging	560,000	489,000

	$2,248,000	$2,950,000
Less: Reserve for Obsolescence	161,000	211,000
	$2,087,000	$2,739,000

E. REVOLVING CREDIT LOAN

On December 2, 2004, the Company obtained an $11 million borrowing facility from LaSalle Business Credit, LLC, consisting of (a) a $7,000,000 revolving loan, with interest payable at 1/4 of 1% over the LaSalle Bank prime lending rate, (b) a $2,000,000, five-year, "Term Loan A", with interest payable at 1/4 of 1% over the LaSalle Bank prime lending rate, payable interest only for the first two years with principal payments beginning in year 3 (based on a 7 year amortization schedule), the proceeds of which were used to repay outstanding loans, (c) a $1,000,000, two year, "Term Loan B", with interest payable at 1.50% over the LaSalle Bank prime lending rate, payable in equal monthly installments commencing January 1, 2005, the proceeds of which are to be used for working capital, and (d) a $1,000,000 capital equipment line, with interest at 1.25% over the LaSalle Bank prime lending rate, the proceeds of which are to be used to purchase equipment. The commitment contains various

restrictive covenants. In addition, the Company is required to maintain defined levels of net worth annually. At December 31, 2004, due to a significant adverse pricing move between the price of cheese and the price of milk for the month of December, the Company was in default of certain covenants under its borrowing facility for the test period ended December 31, 2004. On February 14, 2005, LaSalle and the Company entered into a First Amendment and Waiver to its Loan and Security Agreement which, among other things, waived the foregoing defaults, amended such covenants on a going forward basis, and suspended the capital expenditure loans unless and until (m) on or before February 15, 2006, LaSalle Business Credit, LLC shall have received the Company's internally-prepared quarterly financial statements for the fiscal quarter ended December 31, 2006, and (n) the Company shall have maintained a ratio of its FC Numerator to Fixed Charges of not less than 1.20 to 1.00 with respect to the twelve (12) month period then ended. At March 31, 2005, due to a significant adverse pricing move between the price of cheese and the price of milk for the month of February, the Company was in default of certain covenants under its borrowing facility, for the test period ended March 31, 2005, relating to, among other things, the maintenance of a Tangible Net Worth of not less than $2,500,000, and the maintenance of a Fixed Charge Coverage Ratio of not less than 1.00 x 1.00. On July 14, 2005 the Company has received waivers for the existing defaults at March 31, 2005 and amended such covenants to suspend the Company's compliance with (r) the Tangible Net Worth Covenant for the test periods ended April 30, 2005, May 31, 2005 and June 30, 2005, and (s) the Fixed Charge Coverage test for the ten (10) month period ended April 30, 2005, the eleven (11) month period ending May 31, 2005, and the twelve (12) month period ended June 30, 2005. Also, the Company's borrowing facility was amended to (x) reduce the total borrowing facility to $9,200,000 from $11,000,000, (y) reduce the revolving loan to $5,500,000 from $7,000,000, and (z) reduce the capital expenditure loans to $700,000 from $1,000,000 and make it subject to various conditions precedent.

F. EARNINGS PER SHARE

Basic earnings per share are computed by dividing net earnings

available to common shareholders by the weighted average common shares outstanding for the period. Diluted earnings per share is computed by dividing net earnings available to common shareholders by the weighted average common shares outstanding adjusted for the dilutive effect of options granted under the Company's stock option plans, outstanding warrants, and convertible preferred stock.

At June 30, 2005 and 2004, 1,166,666 and 1,382,666, respectively, of potential common shares, issuable upon conversion of preferred stock and exercise of warrants are excluded from the determination of diluted earnings per share as the related contingencies have not been met. The 395,000 potential common shares from stock options are excluded from the determination of diluted earnings per share at June 30, 2005 as their affect would be antidilutive. The dilutive effect of 330,000 potential common shares at June 30, 2004, are outlined in the following schedule:

	Three Months Ended June 30, 2005	Three Month Ended June 30, 20
Numerator:		
Net income (Loss) -basic	$ (574,000)	$ 475,00
Net income (Loss)- diluted	$ (574,000)	$ 475,00
Denominator:		
Denominator for basic earnings (Loss) per share Weighted avg. shares	3,353,937	3,137,93
Effect of dilutive securities Stock options	--	96
Denominator for diluted earnings (Loss) per share	3,353,937	3,138,89
Earnings (Loss) per share:		
Basic:	$ (0.17)	$ 0.1
Diluted:	$ (0.17)	$ 0.1

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

General

The Company's low moisture mozzarella cheese, which accounts for a significant portion of the Company's sales, is a commodity item. The Company prices this product competitively with others in the industry off of the Chicago Mercantile Exchange Block Cheddar Market (CME Block Market). The price the Company pays for fluid milk and condensed skim milk solids, a significant component of cost of goods sold, is not determined until the start of the month after its cheese has been sold. Thus, the company must produce and sell its cheese without knowing the cost of making the cheese. Generally, the price of milk for any particular month, is computed, based on formulas determined by the United States Department of Agriculture (USDA), by the National Agricultural Statistical Service (NASS) after the end of the month by reference to the average selling price of block cheddar cheese, barrel cheddar cheese, butter, non-fat dry milk and whey. Thus, everything else being equal and there being stability in the price of cheese, the price of milk will follow the price of cheese in an orderly manner, the normal spread between the selling price of cheese and the cost of milk will be maintained, and there will be stability in the Company's gross profit margin. However, sometimes things are not equal. For one thing, the market information required by NASS to compile the price of milk is not immediately available and takes time to collect. For this reason, the commodity prices used to calculate the milk price is two weeks old when the NASS receives it at the end of a particular month (i.e. it includes the commodity prices for two weeks of the current month and two weeks of the prior month), creating a "lag" between the data used for determining the selling price of cheese for the month (the CME Block Market prices for the month) and the data used for determining the cost of milk for the month. Thus, if there is a precipitous increase or decrease in the price of block cheddar cheese during a given month, it may not be reflected in the average selling price of block cheddar cheese utilized in computing the price of milk for such month. In such event, there is a disconnect between the average price of cheese for the month and the cost of milk for the month, and the price of milk does not increase or decrease as fast as the price of cheese. As a consequence thereof, the Company's gross profit margin for its product is subject to fluctuation, which fluctuation, however slight, can have a significant effect on profitability.

Results for the quarter ended June 30, 2005 were down significantly from 2004. Sales were down due to lower market prices. The volume of cheese sold was up 166,000 pounds compared to 2004, but the average CME Block market averaged only $1.51 compared to $1.95 in 2004. The spread between the selling price of cheese and the cost of milk remained lower than historical averages (as they did for most of the fiscal year ended March 31, 2005). This coupled with high protein costs and lower cheese sales led to a much lower gross profit for the first quarter of 2005. These strained gross profits have affected all cheese makers throughout the United States. The Company is unable to predict any future increase or decrease in the prices in the CME Block Market as such market is subject to fluctuation based on factors and commodity markets outside the control of the Company. Although the cost of fluid milk does tend to move correspondingly with the CME Block Market, the extent of such movement and the timing thereof is not predictable. As a result of these factors, the Company is unable to predict pricing trends.

The Company has developed a business plan designed to improve gross margins and reduce its dependency on the spread allowed by the calculation of the milk price. The plan calls for various capital improvements that will

significantly reduce the cost of producing cheese and change the type of whey produced by the Company to whey protein concentrate for human and animal consumption. The capital improvements needed to achieve the business plan will require an infusion of capital of approximately $8,000,000. Discussions are currently underway with St. Albans Cooperative, the Company's milk supplier, the Vermont Economic Development Authority, the United States Department of Agriculture, the Franklyn County Economic Development Authority, the Village of Swanton, Vermont, UPS Business Credit, LLC and LaSalle Business Credit, LLC to structure a financing package that would provide a portion of such financing as well as strengthen the Company's balance sheet. Also, the Company is having conversations with a potential joint venture partner that would provide the necessary financing to modify the Company's whey facility. There can be no assurance that such a financing package or joint venture will be forthcoming.

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

Sales for the three month period ended June 30, 2005 decreased to $10,889,000 from $12,964,000 for the comparable period in 2004, a decrease of $2,075,000 or (16.0%). Approximately $2,987,000 or (110%) was due to a decrease in the average selling price per pound of cheese comparing $1.60 this year versus $2.06 last year. Like the cheese market, the whey market also experienced a lower market. The Dry Sweet Whey Market, upon which the company bases the selling price of its whey, averaged $.26 for the three month period ended June 30, 2005 compared to $.30 for the comparable period in 2004. Sales for whey amounted to $318,000 in 2005 compared to $521,000 for the same period last year, a decrease of $203,000 (or 39.0%).

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Cost of sales and gross profit margin for the three month period ended June 30, 2005 were $10,580,000 or (97.2% of sales) and, $309,000 or (2.8% of sales), respectively, compared to a cost of sales and gross profit margin of $11,774,000 or (90.8% of sales) and $1,190,000 or (9.2% of sales), respectively, for the comparable period in 2004. The increase in the cost of sales and corresponding decrease in gross profit margin as a percentage of sales, for the three month period ended June 30, 2005, were the result of a larger increase in the price of milk compared to the increase in the price of cheese. As discussed above, the spread between the selling price of cheese and the cost of milk was well below historical averages during the three month period ended June 30, 2005. Manufacturing overhead applied to cost of sales was less than 2004.

Selling, general, and administrative expenses for the three-month period ended June 30, 2005 amounted to $635,000 (or 5.8% of sales) compared to $471,000 (or 3.5% of sales) for the comparable period in 2004. Higher labor costs accounted for half of the increase. A new CFO was hired in February 2005 at a higher pay rate than his predecessor, and salary increases were awarded to other employees on the payroll. Travel and entertainment and commissions were up $20,000 and $17,000, respectively, in an effort to bolster sales. Bank charges were up $20,000 due to loan covenant waiver fees.

Interest expense for the three month period ended June 30, 2005 amounted to $248,000 compared to $243,000 for the same period of the prior year, a slight increase of $5,000.

There is no provision for income tax for the three month period ended June 30, 2005 due to the Company having a loss before income taxes of $574,000 coupled with the fact that any deferred tax assets would have full valuation allowances against them. The provision for income tax for the period ended June

30, 2004 reflects a minimum state tax, with the tax benefits of operating losses being offset by the effect of changes in the valuation allowance. Such amounts are re-evaluated each period based on the results of operations.

The company's net loss was $574,000 for the three month period ending June 30, 2005 compared to net income of $475,000 for the comparable period in 2004, an decrease of $1,049,000. The primary factors contributing to these changes are discussed above.

Liquidity and Capital Resources

On December 2, 2004, the Company obtained an $11 million borrowing facility from LaSalle Business Credit, LLC, consisting of (a) a $7,000,000 revolving loan, with interest payable at 1/4 of 1% over the LaSalle Bank prime lending rate, (b) a $2,000,000, five-year, "Term Loan A", with interest payable at 1/4 of 1% over the LaSalle Bank prime lending rate, payable interest only for the first two years with principal payments beginning in year 3 (based on a 7 year amortization schedule), the proceeds of which were used to repay outstanding loans, (c) a $1,000,000, two year, "Term Loan B", with interest payable at 1.50% over the LaSalle Bank prime lending rate, payable in equal monthly installments commencing January 1, 2005, the proceeds of which are to be used for working capital, and (d) a $1,000,000 capital equipment line, with interest at 1.25% over the LaSalle Bank prime lending rate, the proceeds of which are to be used to purchase equipment. The commitment contains various

restrictive covenants. In addition, the Company is required to maintain defined levels of net worth annually. At December 31, 2004, due to a significant adverse pricing move between the price of cheese and the price of milk for the month of December, the Company was in default of certain covenants under its borrowing facility for the test period ended December 31, 2004. On February 14, 2005, LaSalle and the Company entered into a First Amendment and Waiver to its Loan and Security Agreement which, among other things, waived the foregoing defaults, amended such covenants on a going forward basis, and suspended the capital expenditure loans unless and until (m) on or before February 15, 2006, LaSalle Business Credit, LLC shall have received the Company's internally-prepared quarterly financial statements for the fiscal quarter ended December 31, 2006, and (n) the Company shall have maintained a ratio of its FC Numerator to Fixed Charges of not less than 1.20 to 1.00 with respect to the twelve (12) month period then ended. At March 31, 2005, due to a significant adverse pricing move between the price of cheese and the price of milk for the month of February, the Company was in default of certain covenants under its borrowing facility, for the test period ended March 31, 2005, relating to, among other things, the maintenance of a Tangible Net Worth of not less than $2,500,000, and the maintenance of a Fixed Charge Coverage Ratio of not less than 1.00 x 1.00. On July 14, 2005 the Company has received waivers for the existing defaults at March 31, 2005 and amended such covenants to suspend the Company's compliance with (r) the Tangible Net Worth Covenant for the test periods ended April 30, 2005, May 31, 2005 and June 30, 2005, and (s) the Fixed Charge Coverage test for the ten (10) month period ended April 30, 2005, the eleven (11) month period ending May 31, 2005, and the twelve (12) month period ended June 30, 2005. Also, the Company's borrowing facility was amended to (x) reduce the total borrowing facility to $9,200,000 from $11,000,000, (y) reduce the revolving loan to $5,500,000 from $7,000,000, and (z) reduce the capital expenditure loans to $700,000 from $1,000,000 and make it subject to various conditions precedent.

At June 30, 2005, the Company had working capital of $1,726,000 as compared to working capital of $3,607,000 at March 31, 2005. The Company's

revolving bank line of credit is available for the Company's working capital requirements.

At June 30, 2005, $4,404,000 was outstanding under the revolving credit line and $174,000 was available for additional borrowing.

In connection with the LaSalle Business Credit, LLC borrowing facility, St. Albans Cooperative Creamery, Inc., the Company's milk supplier, agreed to subordinate to LaSalle a $1,500,000 outstanding trade account payable due from the Company to St. Albans, on which trade account payable the Company is paying interest at the Bank North short-term repo rate. Pursuant to the terms of the subordination, St. Albans may receive, so long as no default exists with respect to the LaSalle borrowing facility (a) regularly scheduled payments of interest and principal, on a current basis, up to a maximum of $75,000 in any fiscal year of the Company (the "Basic Payment"), and (b) commencing with the Company's fiscal year ended March 31, 2006, a prepayment in an amount equal to 10% of the Company's Excess Cash Flow (as defined in the LaSalle lending documents) for the fiscal year, minus the amount of the Basic Payment made to St. Albans during the fiscal year, and (c) if LaSalle elects to defer all or a portion of its right to be paid 25% of the Company's Excess Cash Flow for any fiscal year (the "Deferred Amount"), St. Albans may receive an additional payment not to exceed the Deferred Amount, provided, however that the payments contemplated by clauses (b) and (c) may only be paid to St. Albans so long as and to the extent that at the time of and at all times during the thirty (30) day period immediately preceding such payments and after giving effect to such payments, the Company has Excess Availability (as defined in the LaSalle lending documents) of at least $300,000. Also, St. Albans may receive, toward the payment of such trade account payable, fifty percent (50%) of the amount of new equity capital raised by the Company in excess of six million dollars.

On February 8, 1999, a $4,950,000 bank loan agreement was signed. The loan is collateralized by the Company's plant and equipment and guaranteed by the USDA. Provisions of the loan are as follows:

A $3,960,000 commercial term note with interest fixed at 9.75 percent having an amortization period of 20 years with maturity in February, 2019.

A $990,000 commercial term note with interest fixed at 10.75 percent having an amortization period of 20 years with maturity in February 2019.

On May 16, 2002, the Company entered into an agreement with St. Albans Cooperative Creamery, Inc. ("St. Albans"), the Company's primary supplier of raw materials, pursuant to which St. Albans (i) converted $1,000,000 of accounts payable owed by the Company to St. Albans into 333,333 shares of common stock, (ii) converted $3,500,000 of accounts payable owed by the Company to St. Albans into (A) preferred stock convertible into 583,333 shares of common stock, which preferred stock (1) automatically converts into such number of shares of common stock if the common stock is $8.00 or higher for 30 consecutive trading days, and (2) may be redeemed by the Company for $3,500,000, and (B) a 10-year warrant to purchase 583,333 shares of common stock (subject to adjustment under certain circumstances to a maximum of 1,416,667 shares of common stock) at $.01 per share, which warrant (1) may not be exercised for a period of three-years, (2) terminates if, during such three-year period, the Company's common stock is $8.00 or higher for 30 consecutive trading days, and, (3) in the event the Company's common stock is not $8.00 or higher for 30 consecutive trading days during such three-year period, may only be exercised on the same basis percentage wise as the preferred shares are converted, (iii) converted an

additional $1,000,000 of accounts payable owed by the Company to St. Albans into a convertible promissory note due on April 14, 2005, which note was convertible into common stock at $6.00 per share at any time by St. Albans and, at the option of the Company, automatically converts into common stock at $6.00 per share if the common stock was $8.00 or higher for a period of 30 consecutive trading days, and (iv) provided the Company with a pricing structure for milk and milk by-products, for a minimum of one-year and a maximum of four-years (subject to renegotiation at the expiration of the applicable period), designed to produce profitability for the Company. The $1,000,000 convertible promissory note was paid as part of the refinancing arrangement with LaSalle Business Credit, LLC. The applicable period for the milk and milk by-products pricing structure expired in May 2003. Thereafter, St. Albans maintained the pricing structure through June 30, 2003. Commencing July 2, 2003, and again as of September 1, 2003, the pricing structure was modified to progressively decrease the benefits accruing to the Company in light of the profitability of the Company.

The Company's major source of external working capital financing is the revolving line of credit. For the foreseeable future the Company believes that the Company's revolving line of credit will continue to represent the major source of working capital financing besides any income generated from operations. Currently, the Company is seeking, as part of the financing package discussed above, an enhancement of $750,000 to the revolving line of credit to be guaranteed by the Vermont Economic Development Authority (VEDA). However, there is no assurance that the enhancement to the revolving line of credit can be secured and failure to secure such enhancement can have a significant negative effect on the Company's liquidity.

For the three-month period ended June 30, 2005, cash provided by operating activities was $1,634,000. Significant operating losses contributed to the use of cash for operating activities mostly due to low gross margins as explained above. Efforts to reduce inventory and accounts receivable generated $1,348,000 in cash flow offsetting cash used by operating losses. An increase in accounts payable provided the rest of the cash provided by operating activities. The Company's Business Plan is designed to improve gross margins and reduce its dependency on the spread between the selling price of cheese and the cost of milk. The Business Plan will be executed when financing efforts for capital improvements are completed as explained above. There is no assurance that financing for the Business Plan can be secured and failure to secure such financing can have a significant negative effect on the Company's liquidity.

Net cash used in investing activities was $36,000 for the three month period ended June 30,2005, which represented purchase of property, plant and equipment. Net cash used in financing activities was $1,518,000 for the three month period ended June 30,2005. Cash generated through the reduction of inventory and accounts receivable and the increase in accounts payable was used to pay down the revolving line of credit with LaSalle Bank. Installment payments on term debt with LaSalle Bank amounted to $125,000 for the quarter.

Safe Harbor Statement

This Quarterly Report on Form 10-Q (and any other reports issued by the Company from time to time) contains certain forward-looking statements made in reliance upon the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are based on current expectations that involve numerous risks and uncertainties. Actual results could differ materially from those anticipated in such forward-looking statements as a

result of various known and unknown factors including, without limitation, future economic, competitive, regulatory, and market conditions, future business decisions, the uncertainties inherent in the pricing of cheese on the Chicago Mercantile Exchange upon which the Company's prices are based, changes in consumer tastes, fluctuations in milk prices, and those factors discussed above under Management's Discussion and Analysis of Financial Condition and Results of Operations. Words such as "believes," "anticipates," "expects," "intends," "may," and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. The Company undertakes no obligation to revise any of these forward-lookingstatements.

ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURE ABOUT MARKET RISK

The Company is subject to interest rate exposure on variable rate debt. The amount of that debt at the balance sheet date, June 30, 2005 and March 31, 2005 amounted to $7,154,000 and $8,626,000, respectively. Since the interest rate on debt is based upon the prime rate plus .25%, or 1.50%, the cost of this debt will increase or decrease accordingly with changes in the prime rate.

The Company has exposure to the commodity price for cheese, dry whey and fluid milk. We have addressed these exposures in the general paragraph of Management's Discussion and Analysis, Item 2 above.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this Report on Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic SEC filings and ensures that information required to be disclosed by the Company in the report it files or submits under the Exchange Act is recorded, processed, summarized and reported, within time periods specified by the rules and forms.

The Company and its auditors had identified deficiencies within its internal control framework which, if left uncorrected could result in a material control weakness. Our internal control deficiencies related to the account reconciliation process and lack of compliance with established procedures for monitoring and adjusting balances relating to certain accruals and provisions. As a result of the above actions, a reorganization and centralization of its accounting department, has been implemented. Procedures have also been implemented to monitor and adjust all balances and provisions.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings
None

Item 2. Unregistered Sale of Equity Securities and Use of Proceeds; Purchase of Equity, Securities By Issuer and Affiliated Purchasers None

Item 3. Defaults Upon Senior Securities
None

Item 4 Submission of Matters to a Vote of Security Holders
None

Item 5 Other Information
None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

31.1 Certification of Periodic Report pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Periodic Report pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on form 8-K filed in the quarter ended June 30, 2005.
None

SIGNATURES

Pursuant to the requirements of the Securities and 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

Lucille Farms, Inc.
(Registrant)

By: /s/ Jay Rosengarten

Jay Rosengarten,
Chief Executive Officer

By: /s/ Don Desjarlais

Don Desjarlais,
Chief Financial Officer
(chief financial and accounting officer)

EXHIBIT INDEX

Exhibit Number	Description of Exhibit
31.1*	Certification of Periodic Report pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Periodic Report pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. 18 U.S.C. Section 1350.
32.2*	Certification of Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002,18 U.S.C.Section 1350.

* Filed herewith