LUCILLE FARMS INC
Form 10-Q
November 15, 2004

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:
September 30, 2004
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)
150 River Road, P.O. Box 517 Montville, New Jersey	07045
(Address of Principal Executive Offices)	(zip code)

(Registrant's Telephone Number, Including Area Code)
(973)334-6030

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 November 11, 2004 was 3,353,937.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LUCILLE FARMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
ASSETS

	SEPTEMBER 30, 2004 (UNAUDITED)	MARCH 31, 2004
CURRENT ASSETS:		
Cash and cash equivalents	$ 332,000	$ 611,000
Accounts receivable, net of allowances of $179,000 at September 30, 2004 and $170,000 at March 31, 2004	4,825,000	4,618,000
Inventories	3,138,000	3,234,000
Prepaid expenses and other current assets	567,000	684,000
Total current assets	8,862,000	9,147,000
PROPERTY, PLANT AND EQUIPMENT, NET	9,346,000	9,579,000
OTHER ASSETS:		
Deferred costs, net	205,000	215,000
Other	22,000	19,000
Total other assets	227,000	234,000
TOTAL ASSETS	$18,435,000	$18,960,000

See accompanying notes to consolidated financial statements

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

	SEPTEMBER 30, 2004 (UNAUDITED)	MARCH 31, 2004

CURRENT LIABILITES:		
Revolving credit loan	$ 4,496,000	$ 4,281,000
Accounts payable	3,755,000	3,970,000
Current portion of long-term debt	1,687,000	711,000
Accrued expenses	461,000	568,000
Total Current Liabilities	10,399,000	9,530,000
LONG-TERM LIABILITY:		
Long-term debt	4,854,000	6,423,000
TOTAL LIABILITIES	15,253,000	15,953,000
STOCKHOLDERS' EQUITY:		
Preferred Stock $0.001 par value 250,000 shares authorized, 216 shares Series A convertible issued and outstanding	--	1,000
583 shares Series B convertible issued and outstanding	1,000	1,000
Common stock, $ 0.001 par value, 25,000,000 shares authorized, 3,354,675 shares issued, 3,354,675 outstanding at September 30, 2004 and 3,137,937 outstanding at March 31, 2004	4,000	3,000
Additional paid in capital	8,548,000	8,548,000
Accumulated deficit	(5,059,000)	(5,234,000
	3,494,000	3,319,000
Less cost of 216,738 shares of treasury stock	(312,000)	(312,000
Total Stockholders' Equity	3,182,000	3,007,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 18,435,000	$ 18,960,000

See accompanying notes to consolidated financial statements

LUCILLE FARMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

THREE MONTHS ENDED SEPTEMBER 30

	2004	2003
SALES	$ 11,752,000	$ 10,839,000
COST OF SALES	11,301,000	9,892,000
GROSS PROFIT	451,000	947,000
OTHER EXPENSE/:		
SELLING	199,000	180,000
GENERAL AND ADMINISTRATIVE	318,000	267,000
INTEREST EXPENSE	234,000	180,000
TOTAL OTHER EXPENSE	751,000	627,000
INCOME (LOSS) BEFORE INCOME TAXES	(300,000)	320,000
PROVISION FOR INCOME TAXES	--	1,000
NET INCOME (LOSS)	$ (300,000)	$ 319,000
EARNINGS (LOSS) PER SHARE BASIC:	$ (.09)	$ .10
DILUTED:	$ (.09)	$ .10
WEIGHTED AVERAGE SHARES OUTSTANDING USED TO COMPUTE NET INCOME PER SHARE BASIC:	3,338,817	3,137,937
DILUTED:	3,338,817	3,137,937

See accompanying notes to consolidated financial statements

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

SIX MONTHS ENDED SEPTEMBER 30

	2004	2003
SALES	$24,716,000	$19,349,000
COST OF SALES	23,075,000	17,784,000
GROSS PROFIT	1,641,000	1,565,000
OTHER EXPENSE		
SELLING	440,000	404,000
GENERAL AND ADMINISTRATIVE	548,000	454,000
INTEREST EXPENSE	477,000	365,000
TOTAL OTHER EXPENSE	1,465,000	1,223,000
INCOME BEFORE INCOME TAXES	176,000	342,000
PROVISION FOR INCOME TAXES	1,000	1,000
NET INCOME	$ 175,000	$ 341,000
EARNINGS PER SHARE BASIC:	$ .05	$ .11
DILUTED:	$ .05	$ .11

WEIGHTED AVERAGE SHARES

OUTSTANDING USED TO COMPUTE NET INCOME PER SHARE		
BASIC:	3,239,457	3,186,394
DILUTED:	3,245,143	3,186,394

See accompanying notes to consolidated financial statements

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

SIX MONTHS ENDED SEPTEMBER 30

	2004	2003
Cash flows from operating activities:		
NET INCOME	$ 175,000	$ 341,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	475,000	460,000
Provision for doubtful accounts	9,000	--
(Increase) decrease in assets:		
Accounts receivable	(216,000)	(1,218,000)
Inventories	96,000	(1,107,000)
Prepaid expenses and other current assets	117,000	100,000
Other assets	7,000	102,000
Increase (decrease) in liabilities:		
Accounts payable	(215,000)	1,410,000
Accrued expenses	(107,000)	53,000
Net cash provided by operating activities	341,000	141,000
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(242,000)	(136,000)
Net cash used In investing Activities	(242,000)	(136,000)
CASH FLOW FROM FINANCING ACTIVITIES:		
Proceeds from revolving credit loan-net	215,000	773,000

Principal payments on long-term debt and notes	(593,000)	(642,000)
Net cash provided by (used in) financing activities	(378,000)	131,000
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(279,000)	136,000
CASH AND CASH EQUIVALENTS-BEGINNING	611,000	4,000
CASH AND CASH EQUIVALENTS-ENDING	$ 332,000	$ 140,000
Non-Cash Financing Activity		
Conversion of 216 Series A Convertible Preferred Stock into 216,000 shares of Common Stock	$ 1,000	$ --

See accompanying notes to consolidated financial statements

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

1. The Consolidated Balance Sheet as of September 30, 2004, the Consolidated Statement of Operations for the three and six month periods ended September 30, 2004 and 2003 and consolidated statement of cash flows for the six months period ended September 30, 2004 and 2003 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 September 30, 2004, the results of its operations for the three and six months ended September 30, 2004 and 2003 and its cash flows for the six months ended September 30, 2004 and 2003.

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, 2004 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.

Recent Accounting Pronouncements

The FASB has issued FIN 46 and related revisions, "Consolidation of Variable Interest Entities." FIN 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activity without additional subordinated financial support from other parties. FIN 46 should be applied no later than the end of the first reporting period that ends after March 15, 2004. FIN 46 does not have a material effect on its financial position, results of operations or cash flows of the Company.

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 128, "Interim Financial Reporting" to require disclosure about those effects in interim financial information.

In April 2004, ten-year options to purchase 5,000 shares of the Company's common stock Option Plan were granted to six directors of the Company at an exercise price of $3.00 per share. Such options vest immediately. Fair value was determined on the date of grant using the Black-Scholes option pricing model using an expected dividend yield of 0; a risk free interest rate of 4.4%, expected stock volatility of 116%, and an expected option life of ten years.

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 six-month periods ended September 30, 2004 and 2003 (unaudited).

	3-Mos ended September 30,		6-Mos Septe
	2004	2003	2004
Net (loss) Income as reported	$ (300,000)	$ 319,000	$ 175,000
Deduct: Total stock-based Employee Compensation determined under fair value method for stock options, net of tax	--	--	42,000
Pro forma income (loss) applicable			

to common stockholders	$ (300,000)	$ 319,000	$ 133,000
Basic income (loss) per share, as reported	$ (0.09)	$ .10	$ 0.05
Basic income (loss) per share, pro forma	$ (0.09)	$ .10	$ 0.04
Diluted income (loss) per share, as reported	$ (0.09)	$ .10	$ 0.05
Diluted income (loss) per share, pro forma	$ (0.09)	$ .10	$ 0.04

2. The results of operations for the three and six months ended September 30, 2004 are not necessarily indicative of the results to be expected for the entire fiscal year.

3. Inventories are summarized as follows:

	September 30, 2004	March 31, 2004
Finished goods	$2,170,000	$2,164,000
Raw Materials	439,000	691,000
Supplies and Packaging	529,000	379,000
	$3,138,000	$3,234,000

4. The Company has a $ 5,000,000 revolving credit facility at September 30, 2004. The loan matures on November 30, 2004 at which time the outstanding principal is due. The Company is seeking alternative financing to replace this loan. Should the Company not be able to secure alternative financing by the extended due date, it will request an additional extension of the loan's due date. However, there is no assurance that such financing can be secured or the extension granted. Failure to secure such financing can have a significant negative effect on the Company's ability to fund operational requirements.

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5. Earnings per Share

Basic earnings per share is 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 September 30, 2004 and 2003, 1,166,666 and 1,382,666 potential common shares, respectively, 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 dilutive effect of the 330,000 and 300,000 potential common shares at

September 30, 2004 and 2003, respectively, are outlined in the following schedule:

	Three-Months Ended September 30, 2004	Three Months Ended September 30, 2003	Six Months Ended September 30,200
Numerator:			
Net income (loss)- basic	$ (300,000)	$ 319,000	$ 175,000
Net Income (loss)-diluted	$ (300,000)	$ 319,000	$ 175,000
Denominator			
Denominator for basic earnings per share Weighted avg. shares	3,338,817	3,137,937	3,239,457
Effect of dilutive securities Stock options	--	--	5,686
Denominator for diluted earnings per share	3,338,817	3,137,937	3,245,143
Earnings (loss) per share			
Basic:	$ (0.09)	$ 0.10	$ 0.05
Diluted:	$ (0.09)	$ 0.10	$ 0.05

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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 more than a majority of the Company's sales, is a commodity item. The Company prices this product competitively with others in the industry, which pricing is based on 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 month after its cheese has been sold. The price of milk is based upon the raw milk components and a weighted average of a number of market components. While the Company generally can anticipate a change in the price of milk because of changes in the CME Block Market, it cannot anticipate the full extent thereof. Therefore, if the CME Block Market price to which our selling price is referenced changes at a different rate than the price of milk our margins are affected accordingly. By virtue of the pricing structure in the industry the Company cannot readily pass along to its customers the changes in the cost of milk. As a consequence thereof, the Company's gross profit margin for its products is subject to fluctuation, which fluctuation, however slight, can have a significant effect on profitability.

The Company is unable to predict any future increase or decrease in prices in the CME Block Market as such market is subject to fluctuation based on factors and commodity markets outside of 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.

Three months ended September 30, 2004 compared to the three months ended September 30, 2003

Sales for the three months ended September 30, 2004 increased to $11,752,000 from $10,839,000 for the comparable period in 2003, an increase of $913,000 (or 8.4%). Approximately $772,000 (or 87.7%) was due to an increase in the number of pounds of cheese sold from 6,289,000 pounds in 2003 to 6,790,000 pounds in 2004, an increase of 501,000 pounds (or 8.0%) year to year. Sales for whey amounted to $448,000 in 2004 compared to $340,000 for the same period last year, an increase of $108,000 (or 31.8%).

Cost of sales and gross profit margin for the three-month period ended September 30, 2004 were $11,301,000 (or 96.2% of sales) and $451,000 (or 3.8% of sales), respectively compared to a cost of sales and gross profit margin of $9,892,000 (or 91.3% of sales) and $947,000 (or 8.7% of sales), respectively, for the comparable period in 2003. The increase in the cost of sales and corresponding decrease in gross profit margin for 2004 as a percentage of sales were the result of the selling price per pound of cheese dropping dramatically while the price of milk did not decline proportionately with cheese; thus putting pressure on our gross margins. Cost of sales was also affected by higher natural gas costs, repairs and maintenance expense, and equipment rental.

Selling, general, and administrative expenses for the three-month period ended September 30, 2004 amounted to $517,000 (or 4.4% of sales) compared to $447,000 (or 4.1% of sales) for the comparable period in 2003. Higher commission costs, trade show costs, advertising expenses, bank charges, freight costs and travel expenses accounted for most of the increase in expenses.

Interest expense for the three-month period ended September 30, 2004 amounted to $234,000 compared to $180,000 for the same period last year, an increase of $54,000. Higher balances and a higher interest rate on our revolver loan accounted for the increase year to year.

The provision for income tax for the three month period ended September 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 the operations.

The Company's net loss was $300,000 for the three months ended September 30, 2004, compared to net income of $319,000 for the comparable period in 2003. The primary factors contributing to these changes are discussed above.

Six months ended September 30, 2004 compared to six months ended September 30, 2003

Sales for the six months ended September 30, 2004 increased to $24,716,000 from $19,349,000 for the comparable period in 2003, an increase of $5,367,000 (or 27.7%). Approximately $5,520,000 (or 102.9%) was due to an increase in the average selling price per pound of cheese from $1.43 last year to $1.86 this year. This increase was offset by a decrease in the number of pounds sold from 13,110,000 pounds in 2003 to 12,869,000 in 2004, a decrease of 241,000 pounds (or 1.8%) year to year. Sales for whey amounted to $970,000 in 2004 compared to $678,000 for the same period last year, an increase of $292,000 (or 43%).

Cost of sales and gross profit margin for the six month period ended September 30, 2004 were $23,075,000 (or 93.4% of sales) and $1,641,000 (or 6.6% of sales) compared to a cost of sales and gross profit margin of $17,784,000 (or 91.9% of sales) and $1,565,000 (or 8.1% of sales), respectively, for the comparable period in 2003. The increase in the cost of sales and decrease in gross profit margins can be attributed to higher milk costs, labor costs, higher natural gas costs, repairs and maintenance expenses, cleaning supplies and rent expense.

Selling, general and administrative expenses for the six months ended September 30, 2004 amounted to $988,000 (or 4.0% of sales) compared to $858,000 (or 4.4% of sales) for the comparable period in 2003. Higher commission expenses, trade show costs, advertising expense and bank charges accounted for the increase year over year.

Interest expense (net) for the six months ended September 30, 2004 amounted to $477,000 compared to $365,000 for the six months ended September 30, 2003, an increase of $112,000. The Company's revolving bank line of credit was raised to $5,000,000 during the current year and the interest rate was raised to prime rate plus three percent whereas last year our revolving line of credit was $4,000,000 and the interest rate was prime rate plus two percent. As a result, the Company had larger loan balances and higher interest rates that accounted for the increase.

The provision for income tax for the six-month period ended September 30, 2004 and September 30, 2003 of $1,000 reflect minimum state taxes. Charges for federal income taxes were offset by changes in the valuation allowances for the six months ended September 30, 2004 and September 30, 2003. Such amounts are re-evaluated each quarter based on the results of operations.

The Company's net income of $175,000 for the six months ended September 30, 2004 represents a decrease of $166,000 from the net income of $341,000 for the comparable period in 2003. The primary factors contributing to these changes are discussed above.

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Liquidity and Capital Resources

The Company had available a $5,000,000 revolving credit facility at September 30, 2004, which will mature on November 30, 2004 (with St. Albans Cooperative participating therein to the extent of $4,000,000) at which time the outstanding principal balance is due. The rate of interest on amounts borrowed against the revolving credit facility is based upon the prime rate plus 3% (7.75% at September 30, 2004). Advances under this facility are limited to 50% of inventory (with a cap on inventory borrowing of $1,000,000) and 80% of receivables as defined in the agreement. The commitment contains various restrictive covenants including requiring the Company to generate an increase in its dollar amount of net worth annually. The Company is seeking alternative financing to replace this facility. Should the Company not be able to secure alternative financing by the due date, it will request an extension until such financing is secured. However, there is no assurance that such financing can be secured or that the extension will be granted. Failure to secure such financing or extension can have a significant negative effect on the Company's ability to fund operational requirements.

At September 30, 2004, the Company had negative working capital of ($1,537,000) as compared to negative working capital of ($383,000) at March 31, 2004. The Company's revolving bank line of credit is available for the Company's working capital requirements.

At September 30, 2004, $4,496,000 was outstanding under the revolving credit line.

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 August 26, 2004, CoBank assigned its term loan for $1,000,000 with interest payable at 1% above the prime rate to St. Albans Cooperative Creamery. The loan is repayable in two consecutive annual installments of $500,000 with the next installment due on May 1, 2005. The loan is collateralized by the Company's plant and equipment and is used for working capital. This loan is the result of St. Albans Cooperative Creamery paying off the term loan owed to CoBank by Lucille Farms, Inc.

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 is convertible into common stock at $6.00 per share at any time by St. Albans and, at the option of the Company, automatically shall be converted into common stock at $6.00 per share if the common stock is $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 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.

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The Company's major source of external working capital financing has been the revolving line of credit. For the foreseeable future, assuming the line is replaced, the Company believes that the Company's revolving line of credit will continue to represent the major source of working capital financing besides income generated from operations. However, failure to secure such replacement financing or an extension of such line of credit can have a significant negative effect on the Company's liquidity.

For the six-month period ended September 30, 2004, cash provided by operating activities was $341,000. A profit from operations of $175,000 increased cash. In addition, a decrease in inventory, prepaid expenses and other assets provided cash while an increase in accounts receivable and a decrease in accounts payable and accrued expenses decreased cash.

Net cash used by investing activities was $242,000 for the period ended September 30, 2004, which represented purchase of property, plant and equipment.

Net cash used in financing activities was $378,000 for the period ended September 30, 2004. Payments of the installment to Co Bank of $500,000 and the Company's mortgage payments of $74,000 decreased cash.

The Company presently is seeking to replace its $5,000,000 secured revolving credit line, the maturity of which has been extended to November 30, 2004. The Company estimates that based on current plans and its ability to replace or extend the revolving line of credit, its resources, including revenues from operations and utilization of its revolving credit lines, should be sufficient to meet anticipated needs for the foreseeable future. Failure to secure such financing or receive such extension will result in a significant negative effect on the Company's liquidity.

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-looking statements.

ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURE ABOUT MARKET RISK

In September 2004, the Company began to hedge the risks of the prices in the cheese and milk markets to ensure profitability. The Company has undertaken a program to sell cheese under long-term contracts and to hedge the transaction through the purchase of milk futures. Increases and decreases in the price of milk in the market (resulting in potential losses or profits on the sale of cheese) would generally be offset by corresponding losses and gains on the related hedging instruments, resulting in negligible net exposure for such transactions. To date, the majority of our expense for milk is not hedged.

In designing a specific hedging program approach, the Company considers several factors including offsetting exposures, significance of exposures, costs associated with entering into a particular hedge instrument and potential effectiveness of the hedge. Our hedging program reduces, but does not entirely eliminate, the impact of milk price movements. Due primarily to our limited use of the hedging program to date, the impact of the hedging program on milk expense fluctuations has not been material to our consolidated financial statements.

The Company is subject to interest rate exposure on variable rate debt. The amount of that debt at balance sheet date of September 30, 2004 and March 31, 2004 amounted to $5,496,000, and $5,781,000, respectively. Since the interest rate on debt is based upon the prime rate plus 1% or 3%, the cost of this debt will increase or decrease accordingly with changes in the prime rate.

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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

Within 90 days prior to the date of filing this 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 Securities Exchange Act of 1934 Rule 13a-14. Based upon the 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.

The Company does not expect that its disclosure controls and procedures will prevent all error and all fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

Subsequent to the date of the Company's evaluation, there have been no significant changes in the Company's internal controls or in other factors that could affect internal controls.

PART II - OTHER INFORMATION

Item 2. Changes in Securities and Use of Proceeds

On June 12, 2001, the Company sold $540,000 of Series A Redeemable Convertible Preferred Stock to an accredited investor in exchange for roll drying equipment. The shares were sold pursuant to Section 4(2) of the Securities Act and Rule 506 of Regulation D promulgated thereunder. On July 7, 2004, these shares were converted to 216,000 shares of Lucille Farms common stock per the preferred stock agreement.

On May 16, 2002, Lucille Farms, Inc. entered into an agreement with St. Albans Cooperative Creamery, Inc., the Company's primary supplier of raw materials, pursuant to which St. Albans (i) converted $1,000,000 of accounts payable owed by Lucille Farms 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 is convertible into common stock at $6.00 per share at any time by St. Albans and, at the option of the Company, automatically shall be converted into common stock at $6.00 per share if the common stock is $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 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.

On June 10, 2002, B&W Investment associates, a partnership of which Howard S. Breslow, chairman of the board of the Company is a partner, purchased, for $25,000, a ten year warrant to purchase 500,000 shares of Common Stock at $3.00

per share. This transaction took place in connection with the conversion into equity and long term debt of outstanding accounts payable owed by the Company to St. Albans Cooperative Creamery, Inc. and the revision of the pricing structure for milk and milk by-products.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

10 Loan and Security/Stock Purchase Agreement, dated May 16, 2002, by and among Lucille Farms, Inc., Lucille Farms of Vermont, Inc. and St Albans Cooperative Creamery, Inc. Portions have been omitted pursuant to a request for confidential treatment and have been filed separately with the Securities and Exchange Commission. (1)

31.1 Certification of Periodic Report pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated November 15, 2004.

31.2 Certification of Periodic Report pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated November 15, 2004.

32.1 Certification of Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated November 15, 2004

32.2 Certification of Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated November 15, 2004.

(b) Reports on Form 8-K

Current Report on Form 8-K, filed August 16, 2004, relating to the results of operations for the period ended June 30, 2004.

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: November 15, 2004 Lucille Farms, Inc.

(Registrant)

By: /s/ Jay Rosengarten

Jay Rosengarten,
Chief Executive Officer

By: /s/ Albert Moussab

Albert Moussab,
Chief Financial Officer
(chief financial and accounting officer)

EXHIBIT INDEX

Exhibit Number	Description of Exhibit
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32.2*	Certification of Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated November 15, 2004.

* Filed herewith