LUCILLE FARMS INC
Form 10-Q
February 23, 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:
December 31, 2003
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 February 20, 2004 was 3,137,937.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LUCILLE FARMS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
ASSETS

	DECEMBER
	(UNAUD
CURRENT ASSETS:	
Cash and cash equivalents	$
Accounts receivable, net of allowances of $151,000 at December 31, 2003 and $189,000 at March 31, 2003	4,
Inventories	2,
Prepaid expenses and other current assets	
Due from officers	
Total current assets	7,
PROPERTY, PLANT AND EQUIPMENT, NET	9,
OTHER ASSETS:	
Deferred costs, net	
Other	
Total other assets	
TOTAL ASSETS	$ 17,

See accompanying notes to consolidated financial statements

2

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

DECEMBER

	(UNAUD
CURRENT LIABILITES:	
Revolving credit loan	$ 3,
Accounts payable	3,
Current portion of long-term debt	
Accrued expenses	
Total Current Liabilities	7,
LONG-TERM LIABILITY:	
Long-term debt, less current portion	6,
TOTAL LIABILITIES	14,
STOCKHOLDERS' EQUITY:	
Preferred stock, $ 0.001 per value, 250,000 shares authorized:	
216 shares Series A convertible issued and outstanding	
583 shares Series B convertible issued and outstanding	
Common stock, $ 0.001 par value, 25,000,000 shares authorized, 3,354,675 shares issued, 3,137,937 outstanding at December 31, 2003 and 3,284,775 outstanding at March 31, 2003	
Additional paid in capital	8,
Accumulated deficit	(5,
	3,
Less: cost of 216,738 shares of treasury stock	(
at December 31, 2003 and 69,900 shares of treasury stock at March 31, 2003, respectively	
Total Stockholders' Equity	2,
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 17,

See accompanying notes to consolidated financial statements

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

	THREE 200
SALES	$ 10,
COST OF SALES	10,
GROSS PROFIT	
OTHER EXPENSE:	
SELLING	
GENERAL AND ADMINISTRATIVE	
INTEREST EXPENSE	
TOTAL OTHER EXPENSE	
NET LOSS	$ (
LOSS PER SHARE	
BASIC:	$
DILUTED:	$
WEIGHTED AVERAGE SHARES OUTSTANDING USED TO COMPUTE NET LOSS PER SHARE	
BASIC:	3,
DILUTED:	3,

See accompanying notes to consolidated financial statements

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

	NINE M 20

SALES	$ 30,
COST OF SALES	28,
GROSS PROFIT	1,
OTHER EXPENSE/(INCOME):	
SELLING	
GENERAL AND ADMINISTRATIVE	
GAIN ON DEBT RESTRUCTURING, NET	
INTEREST INCOME	
INTEREST EXPENSE	
TOTAL OTHER EXPENSE	1,
INCOME (LOSS) BEFORE INCOME TAXES	
PROVISION FOR INCOME TAXES	
NET INCOME (LOSS)	$
EARNINGS (LOSS) PER SHARE	
BASIC:	$
DILUTED:	$
WEIGHTED AVERAGE SHARES OUTSTANDING USED TO COMPUTE NET INCOME (LOSS) PER SHARE	
BASIC	3,
DILUTED	3,

See accompanying notes to consolidated financial statements

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

	NINE M 200
Cash flows from operating activities:	
NET INCOME (LOSS)	$
Adjustments to reconcile net Income (loss) to net cash provided by operating activities:	
Gain on debt restructuring	
Depreciation and amortization	
Provision for doubtful accounts	
(Increase) decrease in assets:	
Accounts receivable	(
Inventories	(
Prepaid expenses and other current assets	
Other assets	
Increase (decrease) in liabilities:	
Accounts payable	
Accrued expenses	(
Net cash provided by operating activities	
CASH FLOW FROM INVESTING ACTIVITIES:	
Purchase of property, plant and equipment	(
Net cash used In investing Activities	(
CASH FLOW FROM FINANCING ACTIVITIES:	
(Payments of) proceeds from revolving credit loan-net	
Principal payments on long-term debt and notes	(
Net cash used in financing activities	
NET DECREASE IN CASH AND CASH EQUIVALENTS	
CASH AND CASH EQUIVALENTS-BEGINNING	
CASH AND CASH EQUIVALENTS-ENDING	$

See accompanying notes to consolidated financial statements

LUCILLE FARMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The Consolidated Balance Sheet as of December 31, 2003, the Consolidated Statement of Operations for the three and nine month periods ended December 31, 2003 and 2002 and the Consolidated Statement of Cash Flows

for the nine month periods ended December 31, 2003 and 2002 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. as of December 31, 2003, the results of its operations for the three and nine months ended December 31, 2003 and 2002 and its cash flows for the nine months ended December 31, 2003 and 2002.

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, 2003 included in the Company's Annual Report on Form 10-K as filed with the SEC. The Company also suggests that the Form 8-K's filed with the SEC on October 31, 2003 and November 6, 2003 be read in conjunction with this report.

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. The Company does not expect the adoption of FIN 46 to have a material effect on its financial position, results of operations or cash flows.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This statement amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," for implementation issues related to the definition of a derivative and other FASB projects related to financial instruments. SFAS No. 149 requires that contracts with comparable characteristics be accounted for in a similar fashion. SFAS No. 149 applies prospectively to contracts entered into or modified after September 30, 2003 and for hedging relationships designated after September 30, 2003. The Company does not expect the adoption of SFAS No. 149 to have a material effect on its financial position, results of operations or cash flows.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that financial instruments within the scope of SFAS No. 150 be classified as a liability or an asset. SFAS No. 150 is effective for all financial instruments entered into after May 31, 2003 or otherwise, the beginning of the first interim period after September 15, 2003. The Company does not expect the adoption of SFAS No. 150 to have a material effect on its financial position, results of operations or cash flows.

7

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. The Company has elected not to change to the fair value method of accounting. It also amends the disclosure provisions of SFAS No. 123 to require that, where no election is made to change to the fair value method, prominent disclosure about the effects on operating results of an entity's accounting policy decisions with respect to stock-based employee compensation must be made in the footnotes to the financial statements. SFAS No. 148 also amends APB Opinion No. 128, "Interim Financial Reporting" to require disclosure about those effects in interim financial information. We adopted the disclosure provisions for the year ended March 31, 2003. 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 nine-month periods ended December 31, 2003 and 2002 (unaudited).

8

	3-Mos. ended December 31,		
	2003	2002	
Net (loss) Income as reported	$ (317,000)	$ (295,000)	$
Deduct: Total stock-based Employee Compensation determined under fair value method for stock options, net of tax	--	--	
Pro forma income (loss) applicable to common stockholders	$ (317,000)	$ (295,000)	$
Basic income (loss) per share, as reported	$ (0.10)	$ (0.09)	$
Basic income (loss) per share, pro forma	$ (0.10)	$ (0.09)	$
Diluted income (loss) per share, as reported	$ (0.10)	$ (0.09)	$
Diluted income (loss) per share, pro forma	$ (0.10)	$ (0.09)	$

2. Inventories are summarized as follows:

	December 31, 2003	March 31, 2003
Finished goods	$ 2,089,000	$ 1,345,000
Raw Materials	248,000	440,000
Supplies and Packaging	360,000	400,000
	$ 2,697,000	$ 2,185,000

3. The Company has a $ 4,000,000 revolving credit facility at December 31, 2003. The loan was to expire on September 16, 2003. The bank has extended the loan's maturity to May 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.

4. 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. Potential common shares issuable upon the exercise of stock options and warrants are excluded from diluted earnings loss per share for the three months ended December 31, 2003, and the nine months ended December 31, 2002 because they would be antidilutive. For 2003 and 2002 conversion of preferred stock was not taken into consideration since the contingency for conversion was not met and the effect would be antidilutive.

At December 31, 2003 and 2002, 1,219,333 and 1,169,333 potential common shares, issuable upon the exercise of stock options and warrants, respectively, are excluded from the determination of diluted net loss per share as the effect on such shares is antidilutive.

	Three-Months Ended December 31, 2003	Three Months Ended December 31, 2002	N Dece
Numerator:			
Net income (loss)- basic	$ (317,000)	$ (295,000)	$

Net Income (loss)-diluted	$ (317,000)	$ (295,000)	$
Denominator			
Denominator for basic earnings per share Weighted avg. shares	3,137,937	3,284,775	
Effect of dilutive securities Stock options	--	--	
Denominator for diluted earnings per share	3,137,937	3,284,775	
Earnings (loss) per share			
Basic:	$ (0.10)	$ (0.09)	$
Diluted:	$ (0.10)	$ (0.09)	$

5. For the nine months ended December 31, 2002, non-cash investing and financing activities were $5,500,000 for restructuring accounts payable for a value ascribed to common stock, preferred stock, warrants and debt issued in connection with the restructuring of $4,500,000 (See Note 7). For the nine months ended December 31, 2003, the Company received 146,838 shares of its own stock in full satisfaction of $146,838 of principal and accrued interest due to the Company from three of its officers. Cash paid for interest and taxes were $570,000 and $1,000 and $603,000 and $1,000 for the nine months ended December 31, 2003 and 2002, respectively.

6. In May 2002, the Company restructured $5,500,000 of accounts payable from its main supplier through the issuance of 333,333 shares of common stock, 583 shares of Series B Preferred Stock with a detachable 10-year warrant and a $1,000,000 convertible note payable in April 2005, the aggregate of which had an ascribed value of approximately $4,500,000.

   The restructuring resulted in a gain of $875,000, net of expenses of $125,000 and income taxes calculated to be zero due to the offset of net operating loss carry forwards previously unrealized.

7. In June 2002, the Company issued a 10-year warrant to B & W Investment Associates, a partnership in which the Chairman of the board of the Company is a partner, to purchase 500,000 shares of common stock at $3.00 per share. The warrant was issued to satisfy outstanding professional services in connection with the restructuring of accounts payable.

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 Cheddar 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 December 31, 2003 compared to the three months ended December 31, 2002

Sales for the three months ended December 31, 2003 increased to $10,850,000 from $9,746,000 for the comparable period in 2002, an increase of $1,104,000 or (11.3%). Approximately $1,576,000 or (142%) was due to an increase in the average selling price per pound of cheese from $1.26 for the three month period ended December 31, 2002 to $1.49 for the three month period ended December 31, 2003. This increase was offset by a decrease in the number of pounds sold from 7,159,000 pounds in 2002 to 6,853,000 pounds in 2003, a decrease of 306,000 pounds or (4.3%) year to year and a decrease in the sale of whey of approximately $223,000 or (38.6%). The increase in the average selling price per pound of cheese was the result of a higher CME block cheddar price during the quarter, an average price of $1.46 compared to last year's average of $1.15.

Cost of sales and gross profit margin for the three month period ended December 31, 2003 were $10,493,000 or (96.7% of sales) and $357,000 or (3.3% of sales), respectively, compared to a cost of sales and gross profit margin of $9,374,000 or (96.2% of sales) and $372,000 or (3.8% of sales) respectively for the comparable period in 2002. The increase in the cost of sales and corresponding decrease in gross profit margin for 2003 as a percentage of sales were the result of a falling cheese market and a milk market that did not decline proportionately, squeezing profit margins along with higher waste removal and whey removal costs, warehouse storage expenses, depreciation expense and professional fees. These expenses were partially offset by lower freight costs, utility costs, insurance expense and equipment parts and supplies.

Selling, general, and administrative expenses for the three-month period ended December 31, 2003 amounted to $470,000 (or 4.3% of sales) compared to $471,000

(or 4.8% of sales) for the comparable period in 2002. Lower legal and consulting fees were partially offset by higher officers' salaries and business travel expenses.

Interest expense for the three month period ended December 31, 2003 amounted to $205,000 compared to $196,000 for the period ended December 31, 2002, an increase of $9,000. A higher interest rate on our revolver loan accounted for most of the difference.

The provision for income tax for the period takes advantage of the tax benefits of operating loss carry fowards being offset by the effect of changes in the valuation allowance. Such amounts are re-evaluated each period based on the results of the operation.

The company's net loss of $317,000 for the three month period ended December 31, 2003 is higher than the $295,000 net loss for the comparable period in 2002. The primary factors contributing to these changes are discussed above.

Nine months ended December 31, 2003 compared to nine months ended December 31, 2002

Sales for the nine months ended December 31, 2003 increased to $30,199,000 from $28,262,000 for the comparable period in 2002, an increase of $1,937,000 or (6.9%). Approximately $3,272,000 or (168.9%) was due to an increase in the average selling price per pound of cheese from $1.29 for the nine month period ended December 2002 to $1.45 for the nine month period ended December 2003. This increase was offset by a decrease in the number of pounds sold to 19,963,000 pounds in 2003 from 20,738,000 in 2002, a decrease of 775,000 pounds or (3.7%) year to year and a year to year decrease in the sale of whey of approximately $394,000 or (27.6%).

Cost of sales and gross profit margin for the nine month period ended December 31, 2003 were $28,277,000 or (93.6% of sales) and $1,922,000 or (6.4% of sales) compared to a cost of sales and gross profit margin of $27,522,000 or (97.4% of sales) and $740,000 or (2.6% of sales), respectively, for the comparable period in 2002. The improvement in our gross profit margin can be attributed to lower transportation costs, labor costs, cleaning supplies, and packaging costs. These lower expenses were partially offset by higher ingredient costs, insurance expense, whey removal, depreciation expense and warehouse storage costs.

Selling, general and administrative expenses for the nine months ended December 31, 2003 amounted to $1,328,000 or (4.3% of sales) compared to $1,292,000 or (4.6% of sales) for the comparable period in 2002. Higher wages, business travel expense and promotional allowances were offset by lower professional and consulting fees.

Interest expense (net) for the nine months ended December 31, 2003 amounted to $570,000 compared to $598,000 for the nine months ended December 31, 2002, a decrease of $28,000. The repayment of $500,000 on our term loan with CoBank accounted for the decrease but was partially offset by an increase in the rate on our revolver loan.

The provision for income tax for the nine month periods ended December 31, 2003 and December 31, 2002 of $1,000 reflects minimum state taxes. Charges for federal income taxes were offset by changes in the valuation allowances for the nine months ended December 31, 2003 and December 31, 2002. Such amounts are re-evaluated each quarter based on the results of operations.

The company's net income of $23,000 for the nine months ended December 31, 2003 represents an increase of $299,000 from the net loss of $276,000 for the comparable period in 2002. The primary factors contributing to this change are discussed above.

Liquidity and Capital Resources

The Company had available a $4,000,000 revolving credit facility at December 31, 2003, which matures on May 30, 2004 (with St. Albans Cooperative Creamery, Inc. participating therein to the extent of $3,000,000) 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 New York prime rate plus 2% (6% at December 31, 2003). 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 December 31, 2003, the Company had negative working capital of ($527,000) as compared to negative working capital of ($238,000) at March 31, 2003. The Company's revolving bank line of credit is available for the Company's working capital requirements.

At December 31, 2003, $3,610,000 was outstanding under the revolving credit line and $160,000 was available for additional borrowing.

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 23, 2001, the Company entered into a new term loan with Co Bank for $2,000,000 with interest payable at 1% above the rate of interest established by the bank as its national variable rate. $500,000 of such loan has been repaid and the balance is repayable in three consecutive annual installments of $500,000 with the next installment due on May 1, 2004. The loan is collateralized by the Company's plant and equipment and was used for working capital.

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.

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 nine-month period ended December 31, 2003, cash provided by operating activities was $310,000. A profit from operations of $23,000 increased cash. In addition, increases in accounts payable of $714,000 and decreases in other assets of $106,000 provided cash while increases in accounts receivable of $567,000 and inventory of $512,000 decreased cash.

Net cash used by investing activities was $301,000 for the period ended December 31, 2003, which represented purchase of property, plant and equipment.

Net cash used in financing activities was $9,000 for the period ended December 31, 2003. Payments of the first installment to Co Bank of $500,000 decreased cash.

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

The Company does not utilize market rate sensitive instruments for trading or other purposes.

The Company is subject to interest rate exposure on variable rate debt. The amount of that debt at the balance sheet date, December 31, 2003 and March 31, 2003 amounted to $5,110,000, and $4,924,000, respectively. Since the interest rate on debt is based upon the prime rate plus 1%, or 2%, 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

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, except as discussed in the next paragraph below, in timely alerting them to material information relating to the Company required to be included in the Company's periodic SEC filings.

15

The Company's independent auditors identified a significant internal control deficiency which, if left uncorrected could result in a material weakness. Our significant internal control deficiency related to the failure to record all March 31, 2003 audit adjustments to our subsidiary ledgers. Due to this significant deficiency our March 31, 2003 Federal, New Jersey and Vermont tax returns have not been filed on a timely basis, although all taxes have been paid timely.

The Company does not expect that its disclosure controls and procedures will prevent all errors 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 procedures 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. Corrective action will be taken with regard to significant deficiency noted above.

PART II - OTHER INFORMATION
Item 2. Changes in Securities and Use of Proceeds

On May 16, 2002, the Company 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 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.

16

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)

99.1 Certification of Periodic Report pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated February 20, 2004.

99.2 Certification of Periodic Report pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated February 20, 2004.

99.3 Certification of Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated February 20, 2004.

99.4 Certification of Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated February 20, 2004.

(b) Reports on Form 8-K

Current Report on Form 8-K, filed October 31, 2003, relating to a change in the Company's independent accoutants.

Current Report on Form 8-K, filed November 6, 2003, relating to the results of operations for the period ending September 30, 2003.

(1) Incorporated by reference to the Company's Current Report on Form 8-K, filed July 11, 2002.

17

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: February 20, 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
99.1*	Certification of Periodic Report pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated February 20, 2004.
99.2*	Certification of Periodic Report pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated February 20, 2004.
99.3*	Certification of Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated February 20, 2004.
99.4*	Certification of Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated February 20, 2004.

* Filed herewith