CHEMBIO DIAGNOSTICS, INC.
Form 10-Q
May 05, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

_____

FORM 10 - Q

_____

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended March 31, 2011

OR

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

For the transition period from: _____ to _____

000-30379
(Commission File Number)
Chembio Diagnostics, Inc.
(Exact name of registrant as specified in its charter)

Nevada	88-0425691
(State or other jurisdiction of incorporation)	(IRS Employer Identification Number)

3661 Horseblock Road
Medford, New York 11763
(Address of principal executive offices including zip code)
(631) 924-1135
(Registrant's telephone number, including area code)
___N/A___
(Former Name or Former Address, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes___ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [ ]	Smaller reporting company [X]
(Do not check if a smaller reporting company)	

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

As of May 4, 2010, the Registrant had 63,178,763 shares outstanding of its $.01 par value common stock.

Quarterly Report on FORM 10-Q For The Period Ended

March 31, 2011

Table of Contents

Chembio Diagnostics, Inc.

PART I
Item 1. FINANCIAL STATEMENTS

CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF

- ASSETS -	March 31, 2011 (UNAUDITED)	December 31, 2010
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,797,103	$ 2,136,351
Accounts receivable, net of allowance for doubtful accounts of $20,000 and $35,000 for 2011 and 2010, respectively	1,726,517	3,946,398
Inventories	1,592,070	1,349,161
Prepaid expenses and other current assets	175,814	204,824
TOTAL CURRENT ASSETS	6,291,504	7,636,734
FIXED ASSETS, net of accumulated depreciation	772,290	813,214
OTHER ASSETS:		
License agreements, net of current portion	575,000	600,000
Deposits and other assets	36,226	36,226
TOTAL ASSETS	$ 7,675,020	$ 9,086,174
- LIABILITIES AND STOCKHOLDERS' EQUITY -		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	$ 1,612,540	$ 2,055,943
Current portion of loans payable	56,523	55,817
Deferred research and development revenue	65,000	65,000
License fee payable	-	875,000
Current portion of obligations under capital leases	25,557	24,697
TOTAL CURRENT LIABILITIES	1,759,620	3,076,457
OTHER LIABILITIES:		
Loans payable - net of current portion	171,799	186,197
Obligations under capital leases - net of current portion	7,855	14,576

TOTAL LIABILITIES	1,939,274	3,277,230
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock – 10,000,000 shares authorized, none outstanding	-	-
Common stock - $.01 par value; 100,000,000 shares authorized, 62,550,065 and 61,996,151 shares issued and outstanding for 2011 and 2010, respectively	625,501	622,390
Additional paid-in capital	39,724,605	39,658,617
Accumulated deficit	(34,614,360)	(34,472,063)
TOTAL STOCKHOLDERS' EQUITY	5,735,746	5,808,944
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 7,675,020	$ 9,086,174

See accompanying notes to condensed consolidated financial statements

CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED
(UNAUDITED)

	March 31, 2011	March 31, 2010
REVENUES:		
Net product sales	$ 3,015,063	$ 2,214,897
License and royalty revenue	28,854	21,496
R&D, milestone and grant revenue	591,764	547,022
TOTAL REVENUES	3,635,681	2,783,415
Cost of product sales	1,709,339	1,477,041
GROSS MARGIN	1,926,342	1,306,374
OPERATING EXPENSES:		
Research and development expenses	1,290,142	800,758
Selling, general and administrative expenses	775,371	661,848
	2,065,513	1,462,606
LOSS FROM OPERATIONS	(139,171)	(156,232)
OTHER INCOME (EXPENSES):		
Interest income	1,310	1,110
Interest expense	(4,436)	(2,204)
	(3,126)	(1,094)
LOSS BEFORE INCOME TAXES	(142,297)	(157,326)
Provision for income taxes	-	-
NET LOSS	$ (142,297)	$ (157,326)
Basic and diluted loss per share	$ (0.00)	$ (0.00)
Weighted average number of shares outstanding, basic and diluted	62,284,772	61,986,165

See accompanying notes to condensed consolidated financial statements

CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED
(UNAUDITED)

	March 31, 2011	March 31, 2010
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS:		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers	$ 5,855,562	$ 3,381,234
Cash paid to suppliers and employees	(4,292,294)	(3,572,214)
Interest received	1,310	1,110
Interest paid	(4,436)	(2,204)
Net cash provided by (used in) operating activities	1,560,142	(192,074)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of fixed assets	(46,358)	(72,866)
Net cash used in investing activities	(46,358)	(72,866)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from option exercises	41,521	2,112
Payment of loan and license obligation	(888,692)	(2,373)
Payment of capital lease obligation	(5,861)	(5,111)
Net cash used in financing activities	(853,032)	(5,372)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	660,752	(270,312)
Cash and cash equivalents - beginning of the period	2,136,351	1,068,235
Cash and cash equivalents - end of the period	$ 2,797,103	$ 797,923
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net loss	$ (142,297)	$ (157,326)
Adjustments:		
Depreciation and amortization	87,282	79,628
Provision for doubtful accounts	(15,000)	-

Share based compensation		27,578		75,150
Changes in assets and liabilities:				
Accounts receivable		2,234,881		597,819
Inventories		(242,909)		(423,658)
Prepaid expenses and other current assets		29,010		(18,293)
Deposits and other assets		25,000		18,334
Accounts payable and accrued liabilities		(443,403)		(382,895)
Deferred research and development revenue		-		19,167
Net cash provided by (used in) operating activities	$	1,560,142	$	(192,074)
Supplemental disclosures for non-cash investing and financing activities:				
Deposits on manufacturing equipment transferred to fixed assets	$	-	$	300,000

See accompanying notes to condensed consolidated financial statements

CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2011
(UNAUDITED)

NOTE 1 — DESCRIPTION OF BUSINESS:

Chembio Diagnostics, Inc. (the "Company" or "Chembio") and its subsidiary, Chembio Diagnostic Systems, Inc., develop, manufacture, and market rapid diagnostic tests that detect infectious diseases. The Company's primary products are three rapid tests for the detection of HIV antibodies in whole blood, serum and plasma samples, two of which were approved by the FDA in 2006; the third is sold for export only. Rapid HIV tests represented nearly 96% of the Company's net product sales in the three months ended March 31, 2011 compared with nearly 91% for the three months ended March 31, 2010. The Company also has other rapid tests that together represented approximately 4% and 9% of net product sales in the first three months of 2011 and 2010, respectively. The Company's products are sold, directly and through distributors, to medical laboratories and hospitals, governmental and public health entities, non-governmental organizations, and medical professionals both domestically and internationally. Chembio's products are sold under the Company's STAT PAK®, SURE CHECK® or DPP® registered trademarks, or under the private labels of its marketing partners, for example the Clearview® label owned by Alere North America, Inc. ("Alere"), which is the Company's exclusive marketing partner for its rapid HIV lateral flow test products in the United States. These products employ lateral flow technologies that are proprietary and/or licensed to the Company. All of the Company's new products and all of those that are currently being developed are based on its patented Dual Path Platform (DPP®), which is a unique diagnostic point-of-care platform that has certain advantages over lateral flow technology. In 2009, 2010 and 2011 to date, the Company has completed development of its first five products that employ the DPP®, and the Company has a number of additional products under development that employ the DPP®.

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of Presentation:

The following (a) condensed balance sheet as of December 31, 2010, which has been derived from audited financial statements, and (b) the unaudited interim condensed financial statements as of March 31, 2011 and for the three-month periods ended March 31, 2011 and 2010 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures, which are 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 such rules and regulations, although we believe that the disclosures made are adequate to provide for fair presentation. The interim financial information should be read in conjunction with the Financial Statements and the notes thereto, included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, previously filed with the SEC.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair statement of the Company's condensed consolidated financial position as of March 31, 2011, its condensed consolidated results of operations for the three-month periods ended March 31, 2011 and 2010 and its cash flows for the three-month periods ended March 31, 2011 and 2010, as applicable, have been made. The interim results of operations are not necessarily indicative of the operating results for the full fiscal year or any future periods.

(b) Revenue Recognition

The Company recognizes revenue for product sales in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, "Revenue Recognition" ("SAB 104"). Under SAB 104, revenue is recognized when there is persuasive evidence of an arrangement, delivery has occurred or services have been rendered, the sales price is

determinable, and collectability is reasonably assured. Revenue typically is recognized at time of shipment. Sales are recorded net of discounts, rebates and returns.

For certain contracts, the Company recognizes revenue from non-milestone contracts and grant revenues when earned. Grants are invoiced after expenses are incurred. Revenues from projects or grants funded in advance are deferred until earned.

For the recognition of revenues for certain collaborative research projects defining milestones at the inception of the agreement, the Company applies the milestone method of revenue recognition. Revenues from milestones funded in advance are deferred until the milestone is completed.

As of March 31, 2011 an aggregate of $65,000 of advanced revenues was unearned and is reflected as deferred revenue on the balance sheet.

CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2011
(UNAUDITED)

(c) Inventories:

Inventories consist of the following at:

	March 31, 2011	December 31, 2010
Raw materials	$ 868,795	$ 785,693
Work in process	432,501	235,548
Finished goods	290,774	327,920
	$ 1,592,070	$ 1,349,161

(d) Earnings Per Share:

Basic earnings per share is computed by dividing net income or loss attributable to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted income or (loss) per share reflects the potential dilution from the exercise or conversion of other securities into common stock, but only if dilutive. Diluted loss per share for the three-month periods ended March 31, 2011 and 2010 is the same as basic loss per share, since the effects of the calculation were anti-dilutive due to the fact that the Company incurred losses for those periods. The following securities, presented on a common share equivalent basis for the three-month periods ended March 31, 2011 and 2010, have been excluded from the per share computations:

	For the three months ended	
	March 31, 2011	March 31, 2010
1999 and 2008 Plan Stock Options	5,491,003	5,662,033
Other Stock Options	100,625	124,625
Warrants	2,545,005	4,294,531
	8,136,633	10,081,189

(e) Employee Stock Option Plan:

The Company had a 1999 Stock Option Plan (“SOP”). The number of options available under the SOP was 3,000,000 shares of Common Stock. As of March 31, 2011, there were 1,811,500 outstanding options under this SOP.

Effective June 3, 2008, the Company’s stockholders voted to approve the 2008 Stock Incentive Plan (“SIP”), with 5,000,000 shares of Common Stock. Under the terms of the SIP, the Compensation Committee of the Company’s Board has the discretion to select the persons to whom awards are to be granted. Awards can be incentive stock options, restricted stock and/or restricted stock units. The awards become vested at such times and under such conditions as determined by the Compensation Committee. As of March 31, 2011, there were 56,664 options exercised, 3,348,652 outstanding options under this SIP and 1,594,684 options still available to be issued.

The weighted average estimated fair value, at their respective dates of grant, of stock options granted in the three-month periods ended March 31, 2011 and 2010 was none and $.22 per share, respectively. The fair value of options at the date of grant was estimated using the Black-Scholes option pricing model. The expected volatility is based upon the historical volatility of our stock. The expected term is determined using the simplified method as permitted by SAB 107, as the Company has limited history of employee exercise of options to date.

The assumptions made in calculating the fair values of options are as follows:

	For the three months ended	
	March 31, 2011	March 31, 2010
Expected term (in years)	n/a	5
Expected volatility	n/a	116.82%
Expected dividend yield	n/a	n/a
Risk-free interest rate	n/a	1.43%

The Company's results for the three-month periods ended March 31, 2011 and 2010 include share-based compensation expense totaling $28,000 and $75,000, respectively. Such amounts have been included in the Condensed Consolidated Statements of Operations within cost of goods sold ($4,000 and $8,000, respectively), research and development ($12,000 and $43,000, respectively) and selling, general and administrative expenses ($12,000 and $24,000, respectively). No income tax benefit has been recognized in the statement of operations for share-based compensation arrangements due to the history of operating losses.

CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2011
(UNAUDITED)

Stock option compensation expense for the three-month periods ended March 31, 2011 and 2010 represents the estimated fair value of options outstanding which is being amortized on a straight-line basis over the requisite vesting period of the entire award.

The following table provides stock option activity for the three months ended March 31, 2011:

Stock Options	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2010	5,586,900	$ 0.15	3.59 years	$ 756,990
Granted	300,000	$ 0.27		
Exercised	(259,082)	$ 0.15		
Forfeited/expired /cancelled	(97,250)	$ 0.26		
Outstanding at December 31, 2010	5,530,568	$ 0.16	2.82 years	$ 1,497,063
Granted	-			
Exercised	(311,082)	$ 0.13		
Forfeited/expired/cancelled	(59,334)	$ 0.34		
Outstanding at March 31, 2011	5,160,152	$ 0.16	2.72 years	$ 1,599,736
Exercisable at March 31, 2011	2,616,811	$ 0.13	2.28 years	$ 775,717

As of March 31, 2011, there was $75,000 of net unrecognized compensation cost related to stock options that have not vested, which is expected to be recognized over a weighted average period of approximately .75 years. The total fair value of stock options vested during the three-month periods ended March 31, 2011 and 2010, was approximately none and $47,000, respectively.

(f) Geographic Information:

U.S. GAAP establishes standards for the manner in which business enterprises report information about operating segments in financial statements and requires that those enterprises report selected information. It also establishes standards for related disclosures about products and services, geographic areas, and major customers.

The Company produces only one group of similar products known collectively as “rapid medical tests”. Management believes that it operates in a single business segment. Net product sales by geographic area are as follows:

	For the three months ended	
	March 31, 2011	March 31, 2010
Africa	$ 553,383	$ 496,891
Asia	28,955	51,054
Europe	38,060	32,454
Middle East	7,163	26,943
North America	2,333,600	1,523,637

South America		53,902		83,918
	$	3,015,063	$	2,214,897

CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2011
(UNAUDITED)

(g) Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consist of:

	March 31, 2011	December 31, 2010
Accounts payable – suppliers	$ 862,636	$ 883,719
Accrued commissions	37,755	114,451
Accrued royalties / license fees	362,544	352,285
Accrued payroll	92,089	162,740
Accrued vacation	141,586	129,732
Accrued bonuses	-	140,325
Accrued expenses – other	115,930	272,691
TOTAL	$ 1,612,540	$ 2,055,943

(h) Recent Accounting Pronouncements Affecting the Company

Revenue Arrangements with Multiple Deliverables

In October 2009, the FASB issued authoritative guidance that amends existing guidance for identifying separate deliverables in a revenue-generating transaction where multiple deliverables exist, and provides guidance for allocating and recognizing revenue based on those separate deliverables. The guidance is expected to result in more multiple-deliverable arrangements being separable than under current guidance. This guidance became effective for the Company on January 1, 2011. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

Intangibles – Goodwill and Other

In December 2010, the FASB amended the existing guidance to modify Step 1 of the goodwill impairment test for a reporting unit with a zero or negative carrying amount. Upon adoption of the amendment, an entity with a reporting unit that has a carrying amount that is zero or negative is required to assess whether it is more likely than not that the reporting unit's goodwill is impaired. If the entity determines that it is more likely than not that the goodwill of the reporting unit is impaired, the entity should perform Step 2 of the goodwill impairment test for the reporting unit. Any resulting goodwill impairment should be recorded as a cumulative-effect adjustment to beginning retained earnings in the period of adoption. Any goodwill impairments occurring after the initial adoption of the amendment should be included in earnings. This guidance became effective for the Company on January 1, 2011. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

Broad Transactions – Business Combination

In December 2010, the FASB amended the existing guidance to require a public entity, which presents comparative financial statements, to disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only.

The amendment also expanded the required supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination, which are included in the reported pro forma revenue and earnings. The amendments became effective for the Company on January 1, 2011. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

NOTE 3 — COLLABORATIVE RESEARCH AND DEVELOPMENT ARRANGEMENTS:

a. Oswaldo Cruz Foundation/Fiocruz:

During 2008, the Company signed four Agreements with the Bio-Manguinhos unit of the Oswaldo Cruz Foundation of Brazil ("FIOCRUZ") for the supply, license and transfer of certain products and related technologies from the Company to FIOCRUZ. The agreements are for the following rapid test products: i) DPP® HIV 1/2 Screen, ii) DPP® HIV 1/2 Confirmatory, iii) DPP® Leptospirosis and iv) DPP® Leishmaniasis. These Agreements provide for a staged technology transfer collaboration pursuant to which FIOCRUZ will ultimately be able to fully manufacture the applicable product for supply in Brazil provided certain minimum purchases of products and related components have occurred.

CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2011
(UNAUDITED)

In accordance with guidance, management has concluded the FIOCRUZ events recorded this quarter for Leishmaniasis meet the definition of milestone events. The Company earned $305,000 for the three months ended March 31, 2011. Future milestone revenues expected from the agreements are $100,000.

Under the Leishmaniasis contract, there are additional royalties and purchase commitments due to the Company over the remaining life of the Agreement which will result in a larger revenue stream.

b. Infectious Disease Research Institute (IDRI) Agreement:

In April 2009, Chembio entered into a development agreement for up to approximately $400,000 in connection with the development and initial supply of a low-cost, rapid point-of-care ("POC") test for infectious diseases. The agreement contemplated a period of approximately two years in which the development activity is to be completed.

As of March 31, 2011, the Company received an aggregate of $390,000 in research and development payments from this agreement of which $65,000 is reflected in deferred revenue. Future milestone payments of $10,000 are expected over the next two quarters and will be recognized when the milestones are met.

c. National Institutes of Health (NIH) Grant:

In June 2009, the Company received a $3 million, three-year grant from the United States National Institutes of Health to complete development of a test for Leptospirosis. Grants are invoiced after expenses are incurred. The Company earned an aggregate of $1,548,000 from this grant from inception through March 31, 2011, of which $446,000 was paid to sub-contractors.

In March 2010, the Company received a $3 million, three-year grant from the United States National Institutes of Health to complete development of a test for Tuberculosis. Grants are invoiced after expenses are incurred. The Company earned $48,000 from this grant from inception through March 31, 2011.

NOTE 4 — TERM NOTE, REVOLVING DEMAND NOTE, VEHICLE FINANCING AND LICENSE FEE PAYABLE:

In June 2010, the Company entered into three agreements with HSBC Bank, NA (“HSBC”). The three agreements were: 1) a secured term note (“Term Note”) of $250,000 to be repaid over sixty months; 2) a secured revolving demand note (“Demand Note”) up to $250,000; and 3) a loan and security agreement (“Security Agreement”).

The Term Note is payable at $4,775.29 per month in arrears. The payment was calculated by amortizing the $250,000 note over 60 months at an interest rate of 5.5% per annum. The Term Note matures June, 2015 and is secured under the terms of the Security Agreement.

The Demand Note allows the Company to draw on the line from time to time an amount up to an aggregate of $250,000 outstanding at any one time. The accrued interest on the Demand Note is payable monthly at an interest rate equal to one-quarter percent above prime per annum. The Company can repay any or all of the principal balance outstanding at any time. This is a demand note and is subject to annual reviews, as well as a 30-day clean-up, during which there can be no amounts outstanding.

The Security Agreement contains covenants that place annual restrictions on the Company's operations, including covenants relating to mergers, debt restrictions, capital expenditures, tangible net worth, net profit, leverage, fixed charge coverage, employee loan restrictions, distribution restrictions (common stock and preferred stock), dividend restrictions, restrictions on lease payments to affiliates, restrictions on changes in business, asset sale restrictions, restrictions on acquisitions and intercompany transactions, restrictions on fundamental changes. The Security Agreement also requires that the Company maintain a minimum tangible net worth at all times of greater than $3,000,000 and EBITDA to CMLTD plus interest cannot be less than 1.25 to 1.00 for any fiscal year. (EBITDA is earnings before interest, taxes, depreciation and amortization; CMLTD is defined as any one-year period, the current scheduled principal payments required to be paid for the applicable period.). The Company was in compliance with all required financial covenants at March 31, 2011. The Security Agreement requires that the Demand Note has an annual 30-day clean-up, during which there can be no amounts outstanding.

The Company currently maintains its operating, payroll, and primary cash accounts at HSBC. The balance due on the Term Note as of March 31, 2011 was $217,000 and nothing was drawn down on the Demand Note as of March 31, 2011.

CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2011
(UNAUDITED)

Future minimum payments under the Term Note, excluding interest, as of March 31, 2011 were as follows for the periods ending March 31,

2012	$46,545
2013	49,171
2014	51,944
2015	54,874
2016	14,119
	216,653
Less: current maturities	(46,545)
	$170,108

In June 2009, the Company purchased a vehicle for use by the CEO and obtained financing in the amount of $29,228. The financing is for a period of 3 years; is secured by the vehicle, and is guaranteed by the CEO. The financing agreement provides for monthly principal and interest payments of $849 and carries an interest rate of 2.9% per annum. The balance due on this loan as of March 31, 2011 was $11,669 and is reflected with the Term Note above on the balance sheet as current portion of loans payable of $9,978 and loans payable – net of current portion of $1,691.

In February 2008, the Company entered into a sublicense agreement (the “Agreement”) with Bio-Rad Laboratories, Inc. and Bio-Rad Pasteur (collectively, “Bio-Rad”). Bio-Rad is the exclusive licensee of the HIV-2 patent portfolio held by Institute Pasteur of Paris, France. Pursuant to the terms of the Agreement, Bio-Rad sublicensed to the Company patents related to the manufacture, use or sale of screening assays that detect HIV-2. In exchange for global non-exclusive rights to these patents, the Agreement initially provided that the Company pay Bio-Rad a $1,000,000 sublicense fee; $500,000 payable during 2008, of which $125,000 was paid and $375,000 was payable by December 31, 2008, with the remaining $500,000 being payable by December 31, 2009. On January 29, 2009, the Company and Bio-Rad agreed to amend the Agreement so as to defer the remaining $875,000 of payments due under the Agreement to one payment due in December 2010. The Company paid the $875,000 on January 3, 2011. The Company will also pay Bio-Rad a royalty on net sales in the United States and Canada, if any, of Licensed Products sold under the Company’s brands as defined in the Agreement. The Agreement will continue until the expiration of the last-to-expire (in 2017) of the sublicensed patents, unless otherwise terminated at an earlier date by the Company or Bio-Rad.

NOTE 5 — RIGHTS AGREEMENT:

In March 2010, the Company entered into a Rights Agreement dated March 8, 2010 (the "Rights Agreement") between the Company and Action Stock Transfer Corp., as Rights Agent. Pursuant to the Rights Agreement, the Company declared a dividend distribution of one preferred share purchase right (a "Right") for each outstanding share of Common Stock, $0.01 par value (the "Common Stock"), of the Company. The Board of Directors set the payment date for the distribution of the Rights as March 8, 2010, and the Rights were distributed to the Company’s shareholders of record on that date. The description and terms of the Rights are set forth in the Rights Agreement.

Rights Initially Not Exercisable. The Rights are not exercisable until a Distribution Date. Until a Right is exercised, the holder thereof, as such, will have no rights as a shareholder of the Company, including, without limitation, the right to vote or to receive dividends.

Separation and Distribution of Rights. The Rights will be evidenced by the certificates for shares of Common Stock registered in the names of the holders thereof, and not by separate rights certificates until the earlier to occur of (i) the close of business on the tenth business day following a public announcement that an Acquiring Person (as defined in the Rights Agreement) acquired a Combined Ownership (as defined in the Rights Agreement) of 15% or more of the outstanding shares of the Common Stock (the "Shares Acquisition Date") or (ii) the later of (A) the close of business on the tenth business day (or such later date as may be determined by action of the Board of Directors prior to such time as any person or group of affiliated or associated persons becomes an Acquiring Person) after the date that a tender or exchange offer or intention to commence a tender or exchange offer by any person is first published, announced, sent or given within the meaning of Rule 14d-4(A) under the Securities Exchange Act of 1934, as amended, the consummation of which would result in any person having Combined Ownership of 15% or more of the outstanding shares of the Common Stock, or (B) if such a tender or exchange offer has been published, announced, sent or given before the date of the Rights Agreement, then the close of business on the tenth business day after the date the Rights Agreement was entered into (or such later date as may be determined by action of the Board of Directors prior to such time as any person becomes an Acquiring Person); (the earlier of such dates referred to in (i) and (ii), which date may include any such date that is after the date of the Rights Agreement but prior to the issuance of the Rights, being called the "Distribution Date").

For a more complete description of the material terms of the Rights Agreement and the rights to be issued pursuant thereto, please refer to Item 3.03 of the Company’s Form 8-K Current Report filed with the SEC on March 11, 2010.

CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2011
(UNAUDITED)

NOTE6—COMMITMENTS, CONTINGENCIES, AND CONCENTRATIONS:

(a) Economic Dependency:

The following table discloses product sales the Company had to customers in excess of 10% of net product sales for the periods indicated:

	For the three months ended				Accounts Receivable As of
	March 31, 2011		March 31, 2010		
	Sales	% of Sales	Sales	% of Sales	March 31, 2011
Customer 1	$ 2,055,210	68	$ 1,161,927	52	$ 715,747
Customer 2	$ 459,697	15	*	*	$ 469,872

In the table above, the asterisk (*) indicates that sales to the customer did not exceed 10% for the period indicated.

The following table discloses purchases the Company made from a vendor in excess of 10% of total purchases for the periods indicated:

	For the three months ended				Accounts Payable As of
	March 31, 2011		March 31, 2010		
	Purchases	% of Purc.	Purchases	% of Purc.	March 31, 2011
Vendor 1	$ 108,456	13	$ 107,663	14	$ 10,567

The Company currently buys materials which are purchased under intellectual property rights agreements and are important components in its products. Management believes that other suppliers could provide similar materials on comparable terms. A change in suppliers, however, could cause a delay in manufacturing and a possible loss of sales, which could adversely affect operating results.

(b) Governmental Regulation:

All of the Company's existing and proposed diagnostic products are regulated by the United States Food and Drug Administration, United States Department of Agriculture, certain U.S., state and local agencies, and/or comparable regulatory bodies in other countries. Most aspects of development, production, and marketing, including product testing, authorizations to market, labeling, promotion, manufacturing, and record keeping are subject to review. After marketing approval has been granted, Chembio must continue to comply with governmental regulations. Failure to comply with these regulations can result in significant penalties.

(c) Employment Agreement:

The Company has employment contracts with two key employees. The contracts call for salaries presently aggregating $510,000 per year. One contract expires in May 2012 and one contract expires in March 2013. In connection with the contract that expires March 2013, the Company issued 300,000 options to purchase common stock with one-third vesting immediately and one-third vesting on each of the second and third anniversaries of the

grant.

NOTE7—SUBSEQUENT EVENTS:

On April 26, 2011, warrants to purchase 513,698 shares of common stock were exercised at $.40 per share. The Company received $205,479 for this exercise.

In November 2010, the Company signed an Agreement with the Bio-Manguinhos unit of the Oswaldo Cruz Foundation of Brazil ("FIOCRUZ") for the supply, license and transfer of certain products and related technologies from the Company to FIOCRUZ. The agreements are for the following rapid test products: i) DPP® Syphilis Screen, and ii) DPP® Syphilis Screen and Confirm. This Agreement provides for a staged technology transfer collaboration pursuant to which FIOCRUZ will ultimately be able to fully manufacture the applicable product for supply in Brazil provided certain minimum purchases of products and related components have occurred.

In April 2011, FIOCRUZ informed the Company that ANVISA (the Brazilian regulatory agency) had approved the DPP® Syphilis Screen assay for use in Brazil. This approval triggered a milestone event of $100,000 to the Company. In accordance with guidance, management has concluded the FIOCRUZ event is to be recorded for the second quarter of 2011for Syphilis Screen as it meets the definition of milestone event. The Company earned $100,000 for this milestone event.

Under the Syphilis contract, there are additional royalties and purchase commitments due to the Company over the remaining life of the Agreement, starting in 2011, which will result in a larger revenue stream

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

The terms "Chembio", "Company,", "we", "us", and "our" refer to Chembio Diagnostics, Inc. and its subsidiary a consolidated entity, unless the context suggests otherwise.

Overview

This discussion and analysis should be read in conjunction with the accompanying Condensed Consolidated Financial Statements and related notes. The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"). The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of any contingent liabilities at the financial statement date and reported amounts of revenue and expenses during the reporting period. On an ongoing basis we review our estimates and assumptions. Our estimates were based on our historical experience and other assumptions that we believe to be reasonable under the circumstances. Actual results are likely to differ from those estimates under different assumptions or conditions, but we do not believe such differences will materially affect our financial position or results of operations. Our critical accounting policies, the policies we believe are most important to the presentation of our financial statements and require the most difficult, subjective and complex judgments, are outlined below in ''Critical Accounting Policies,'' and other than stated in Note 2 (b), have not changed significantly from December 31, 2010.

In addition, certain statements made in this report may constitute "forward-looking statements". These forward-looking statements involve known or unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Specifically, 1) our ability to obtain necessary regulatory approvals for our products; and 2) our ability to increase revenues and operating income are dependent upon our ability to develop and sell our products, general economic conditions, and other factors. You can identify forward-looking statements by terminology such as "may," "could", "will," "should," "expects," "intends," "plans," "anti "believes," "estimates," "predicts," "potential," "continues" or the negative of these terms or other comparable terminolo Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

Except as may be required by applicable law, we do not undertake or intend to update or revise our forward-looking statements, and we assume no obligation to update any forward-looking statements contained in this report as a result of new information or future events or developments. Thus, you should not assume that our silence over time means that actual events are bearing out as expressed or implied in such forward-looking statements. You should carefully review and consider the various disclosures we make in this report and our other reports filed with the Securities and Exchange Commission that attempt to advise interested parties of the risks, uncertainties and other factors that may affect our business.

The following discussion and analysis relates to the business of the Company, which consists of the development, manufacture and marketing of rapid diagnostic tests that detect infectious diseases. All of the Company's future products that are currently being developed are based on our patented Dual Path Platform (DPP®), which is a unique diagnostic point-of-care platform that has certain advantages over lateral flow technology. The Company has completed development of five products that employ the DPP® technology, two of which will be marketed under Chembio's label (DPP® HIV 1/2 Screening Assay and DPP® Syphilis Screen & Confirm) and three that have been developed specifically related to technology transfer, supply and license agreements with The Oswaldo Cruz Foundation ("FIOCRUZ") for the Brazilian public health market, as explained below. The DPP® HIV Screening Assay

will be manufactured as an OEM product only for the Brazilian market pursuant to one of our agreements with FIOCRUZ.

During the first three months of 2011, the Company had a total of $1,290,000 of research and development expenses as compared with $801,000 during the first three months of 2010. Approximately $395,000 of this $489,000 increase, or 81% of the increase, is attributable to expenses for clinical trials for its DPP® HIV Screen. Because of the Company's strong operating cash flow during 2010 and 2011 year to date, including but not limited to its receipt of $1.467 million of Qualified Therapeutic Discovery Project grants ("QTDP") under Section 48D of the Internal Revenue Code, as enacted under the Patient Protection and Affordable Care Act of 2010), the Company has been able to accelerate the pace of these clinical trials, which are now over two-thirds completed.

The Company has a number of additional products under development that employ the DPP® technology. These product development activities are further described below.

Oswaldo Cruz Foundation OEM DPP® Agreements - During 2008 we signed four agreements with the Oswaldo Cruz Foundation (FIOCRUZ), which is affiliated with the Ministry of Health in Brazil, relating to products based on our DPP® technology for Leptospirosis, Canine Leishmaniasis, screening for HIV 1/2 with oral fluid and blood samples, and a 5-band multiplex point-of-care confirmation test for HIV 1 and 2. In addition, in 2010 we signed a fifth agreement with FIOCRUZ relating to two DPP® Syphilis rapid tests. We have completed development of all of these products and four products have been approved and two are pending regulatory approval (See REGULATORY ACTIVITIES below).

Bio-Rad Laboratories OEM DPP® Agreement – During 2010 we completed work on a two-year development contract with Bio-Rad Laboratories, Inc. of a six band multiplex product on our DPP® platform after a two-year development phase, which was then followed by a technology transfer phase. After the product development was successfully completed in 2010, Chembio earned a license fee from Bio-Rad and Bio-Rad exercised its option to have the manufacture of the product transferred to Bio-Rad. Chembio will therefore participate in the commercialization of this product through the license agreement that it executed with Bio-Rad, which agreement provides for royalties payable to Chembio at the rate of 7% of Net Sales of licensed products as defined in that agreement. We believe the regulatory submissions by Bio-Rad will commence as soon as practicable. There can be no assurance that Bio-Rad will submit this product for regulatory approval, that the product if submitted will be approved, and if approved will be successfully commercialized and produce royalty income to Chembio.

Battelle/CDC DPP® Influenza Immunity Test – We have completed the development work associated with this project our initial prototypes are being evaluated by Battelle/CDC and recently we were requested by Battelle/CDC to manufacture and supply a larger number of prototypes.

DPP® Hepatitis C and DPP® Hepatitis C/HIV Tests – Various prototypes of these products are being developed and evaluated internally and externally, including a study that was organized by the National Center for HIV/AIDS, Viral Hepatitis, STD, and TB Prevention (NCHHSTP) at the CDC. We have received the confidential results of the study which CDC has submitted for journal publication

DPP® Influenza – We have made significant progress on our multiplex test for FLU A/B Antigen Detection and we are verifying the performance of our prototype in order to begin full validation and commencement of regulatory activities for this product. Our current plan is still for product verification and validation to be completed during the second quarter of 2011 and for our clinical studies to be initiated during the balance of 2011.

DPP® Leptospirosis – We are about halfway through the three-year $3 million Small Business Innovative Research (SBIR) Phase II grant we were awarded in 2009 by the United States National Institutes of Health (NIH) to fully develop, validate, and commercialize a rapid diagnostic test for Leptospirosis for general use worldwide. Our work pursuant to this grant is progressing on schedule. The test will be developed with our DPP® technology and will utilize proprietary reagents developed by Yale University and the Oswaldo Cruz Foundation at the Brazilian Ministry of Health. Development of the test will be in collaboration with the Division of Infectious Diseases, Yale University in New Haven, CT and the Oswaldo Cruz Foundation, the largest biomedical research institution in Latin America.

DPP® Tuberculosis – As reported in February 2011, we were awarded a three-year $2.9 million Small Business Innovative Research (SBIR) Phase II grant from the United States National Institutes of Health (NIH) to continue development of a simple, rapid, accurate, and cost-effective serological test for active tuberculosis that can be utilized in resource-limited settings.

Other Research & Development Activities - Chembio continues to work with commercial, governmental and private organizations in order to obtain R&D contracts and grant funding for development projects. These programs have subsidized the Company's development expenses while expanding the applications for and know-how related to DPP®, and have also served in creating important collaborative relationships.

On November 1, 2010, the Company was notified by the IRS that it received awards in the total amount of $1.467 million relating to six "Qualifying Therapeutic Discovery Projects" under the U.S. Patient Protection and Affordable Care Act of 2010 (P.L. 111-148), a program that was created as part of the major United States federal health care reform legislation enacted earlier this year.

Under the award guidelines, qualified therapeutic discovery projects had to show a reasonable potential to result in new therapies to treat areas of unmet medical need or prevent, detect or treat chronic or acute diseases and conditions,

reduce the long-term growth of health care costs in the United States, or significantly advance the goal of curing cancer within 30 years. Chembio's projects that received awards include products based on the Company's patented DPP® point-of-care diagnostic platform that are in various stages of its development pipeline such as its products for the rapid diagnosis of HIV, Hepatitis-C, and Syphilis.

We also have some smaller research and development agreements and grants in place, and applications for others that are pending.

There can be no assurance that any of these grant applications will result in any funding awards to the Company, nor that any of the existing research and development contracts or grants will continue or that they will meet regulatory or any other technical requirements and specifications, and/or that if continued, will result in completed products, or that such products, if they are successfully completed, can or will be successfully commercialized.

Regulatory Activities

CE Mark for FDA approved HIV tests – The final studies for the CE Marking requirements are underway for our two FDA-approved rapid HIV tests, although we have continued to experience delays. Our revised plan is to collect the remaining data required in order for the study to be submitted during the second quarter of 2011. Submission of the final data will occur shortly thereafter.

Regulatory Approvals in Brazil through the Oswaldo Cruz Foundation (FIOCRUZ) – During 2010 we received notification from FIOCRUZ that our DPP® HIV 1/2 screening test and our DPP® HIV confirmatory test were each approved by Brazil's National Health Surveillance Agency (ANVISA). During the first quarter, as recently reported, our DPP® visceral canine leishmania ("VL") rapid test was approved by Brazil's Ministry of Agriculture, Livestock and Food Supply ("MAPA"). This is the first diagnostic product that FIOCRUZ has successfully submitted for approval to MAPA in Brazil. In addition, we were just notified (see Subsequent Events in the financial statement footnotes above and Recent Events below) that FIOCRUZ has now also received the required approval from ANVISA for the DPP® Syphilis-Treponemal test; we believe the remaining DPP® product approval that FIOCRUZ has pending with ANVISA, which is for the DPP® Leptospirosis test, will be granted soon, although there can be no assurance of this.

FDA Approval for DPP® HIV 1/2 Screening Assay for Oral Fluid - We have collected over 2/3 of the clinical data required for submission to the FDA. As recently reported, we began submitting the PMA (Pre-Marketing Approval) application using the Modular PMA option, and we have thus far submitted the module containing manufacturing information. We anticipate filing the remaining modules during the balance of 2011, although there can be no assurance of this.

DPP® Syphilis Screen & Confirm - We are engaged in a number of activities oriented to commercializing this product. We anticipate commencing clinical trials and other activities in support of a planned 510(K) clearance during the second quarter of 2011.

Recent Events

On April 26, 2011, warrants to purchase 513,698 shares of common stock were exercised at $.40 per share. The Company received $205,479 for this exercise.

In April 2011, FIOCRUZ informed the Company that ANVISA (the Brazilian regulatory agency) had approved the DPP® Syphilis Screen assay for use in Brazil. This approval triggered a milestone event of $100,000 to the Company.

Critical Accounting Policies and Estimates

We believe that there are several accounting policies that are critical to understanding our historical and future performance, as these policies affect the reported amounts of revenue and the more significant areas involving management's judgments and estimates. These significant accounting policies relate to revenue recognition, research and development costs, valuation of inventory, valuation of long-lived assets and income taxes. For a summary of our significant accounting policies, which other than stated in Note 2 (b), have not changed from December 31, 2010, see our Annual Report on Form 10-K for the twelve months ended December 31, 2010, which was filed with the SEC on March 3, 2011.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2011 AS COMPARED WITH THE THREE MONTHS ENDED MARCH 31, 2010

Revenues:

Selected Product Categories:	For the three months ended			
	March 31, 2011	March 31, 2010	$ Change	% Change
HIV	$ 2,891,079	$ 2,007,333	$ 883,746	44.03 %
DPP	51,000	-	51,000	100.00 %
Other	72,984	207,564	(134,580)	-64.84 %
Net Product Sales	3,015,063	2,214,897	800,166	36.13 %
License and royalty revenue	28,854	21,496	7,358	34.23 %
R&D, milestone and grant revenue	591,764	547,022	44,742	8.18 %
Total Revenues	$ 3,635,681	$ 2,783,415	$ 852,266	30.62 %

Revenues for our HIV tests and related components during the three months ended March 31, 2011 increased by approximately $884,000 over the same period in 2010. This was primarily attributable to increased sales to Alere from $1,162,000 during the first three months of 2010 to $2,055,000 during the three months ended March 31, 2011, an increase of $893,000, or 77%. The increase in R&D, milestone and grant revenue was due to revenue generated from grants and development contracts that are related to potential new products utilizing our patented DPP® technology and a milestone event of $305,000 from FIOCRUZ on the approval of the Company's DPP® Leishmaniasis rapid test. R&D, milestone and grant revenue also includes funds from our recent grants from NIH for Human Tuberculosis, which was effective as of March 1, 2011. License and royalty revenue primarily includes royalties from Brazil under our 2004 technology transfer and license agreement.

Gross Margin:

Gross Margin related to Net Product Sales:	For the three months ended			
	March 31, 2011	March 31, 2010	$ Change	% Change
Gross Margin per Statement of Operations	$ 1,926,342	$ 1,306,374	$ 619,968	47.46 %
Less: R&D, milestone, grant, license and royalties	620,618	568,518	52,100	9.16 %
Gross Margin from Net Product Sales	$ 1,305,724	$ 737,856	$ 567,868	76.96 %
Gross Margin %	43.31 %	33.31 %		

The increase in our gross margin percentage was primarily due to an increase in our sales to Alere which are at higher margin than products sold in Africa. This gross margin increase was after approximately $120,000 in an unusually

high scrap expense that was incurred as a result of a product non-conformance detected during quality control in a production batch. Alere sales represented approximately 52% of sales in the three months ended March 31, 2010 as compared to approximately 68% in the three months ended March 31, 2011.

Research and Development:

Research and development expenses include costs incurred for product development, regulatory approvals, clinical trials, and product evaluations.

Selected expense lines:	For the three months ended			
	March 31, 2011	March 31, 2010	$ Change	% Change
Clinical and Regulatory Affairs:				
Wages and related costs	$ 113,020	$ 81,471	$ 31,549	38.72 %
Consulting	-	14,805	(14,805)	-100.00 %
Share-based compensation	2,122	4,667	(2,545)	-54.53 %
Clinical trials	452,064	56,750	395,314	696.59 %
Other	18,896	9,274	9,622	103.75 %
Total Regulatory	586,102	166,967	419,135	

Table of Contents

The purchase price payable, and the number of units of preferred stock or other securities or property issuable upon exercise of the rights are subject to adjustment from time to time to prevent dilution (1) in the event of a stock dividend on, or a subdivision, combination or reclassification of, the preferred stock, (2) if holders of the preferred stock are granted certain rights or warrants to subscribe for preferred stock or convertible securities at less than the current market price of the preferred stock, or (3) upon the distribution to holders of the preferred stock of evidences of indebtedness or assets (excluding regular quarterly cash dividends) or of subscription rights or warrants (other than those referred to above).

With certain exceptions, no adjustments in the purchase price will be required until cumulative adjustments amount to at least 1% of the purchase price. No fractional units will be issued and, in lieu thereof, an adjustment in cash will be made based on the market price of the preferred stock on the last trading date prior to the date of exercise.

At any time until 10 days following the stock acquisition date, we may redeem the rights in whole, but not in part, at a price of $.01 per right. Immediately upon the action of the board of directors ordering redemption of the rights, the rights will terminate and the only right of the holders of rights will be to receive the $.01 redemption price.

Until a right is exercised, the holder thereof, as such, will have no rights as a shareholder of our company, including, without limitation, the right to vote or to receive dividends. While the distribution of the rights will not be taxable to shareholders or to us, shareholders may, depending upon the circumstances, recognize taxable income in the event that the rights become exercisable for Class A common stock (or other consideration) of our company as set forth above.

Any of the provisions of the rights agreement may be amended by our board of directors prior to the distribution date. After the distribution date, the provisions of the rights agreement may be amended by the board of directors in order to cure any ambiguity, to correct or supplement any defective or inconsistent provision, to make changes which do not adversely affect the interests of

holders of rights (excluding the interest of any acquiring person), or to shorten or lengthen any time period under the rights agreement; provided, however, among other things, that no amendment to adjust the time period governing redemption may be made when the rights are not redeemable.

The rights have certain anti-takeover effects. The rights will cause substantial dilution to a person or group that attempts to acquire our company in certain circumstances. Accordingly, the existence of the rights may deter certain acquirors from making takeover proposals or tender offers. However, the rights are not intended to prevent a takeover, but rather are designed to enhance the ability of the board of directors to negotiate with a potential acquiror on behalf of all of the shareholders.

Delaware Takeover Statute

We are subject to Section 203 of the Delaware General Corporation Law. Subject to exceptions set forth in that section, Section 203 prohibits a Delaware corporation from engaging in any business combination with any interested shareholder for a period of three years following the time that such shareholder became an interested shareholder, unless:

prior to such time, the board of directors of the corporation approved either the business combination or the transaction that resulted in the shareholder becoming an interested shareholder;

upon consummation of the transaction that resulted in the shareholder becoming an interested shareholder, the interested shareholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding those shares owned (x) by persons who are directors and also officers and (y) by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or

22

Table of Contents

at or subsequent to such time, the business combination is approved by the board of directors and authorized at an annual or special meeting of shareholders, and not by written consent, by the affirmative vote of at least 66 2/3% of the outstanding voting stock that is not owned by the interested shareholder.

Section 203 defines a business combination to include generally:

any merger or consolidation involving the corporation and the interested shareholder;

any sale, transfer, pledge or other disposition of 10% or more of the assets of the corporation involving the interested shareholder;

any transaction that results in the issuance or transfer by the corporation of any stock of the corporation to the interested shareholder except upon the exercise, exchange or conversion of securities exercisable for, exchangeable for or convertible into stock of such composition, upon a merger of a parent and a subsidiary, or upon an exchange offer by the corporation to purchase stock made on the same terms to all holders of said stock;

any transaction involving the corporation that has the effect of increasing the proportionate share of the stock of any class or series of the corporation beneficially owned by the interested shareholder; or

the receipt by the interested shareholder of the benefit of any loans, advances, guarantees, pledges or other financial benefits provided by or through the corporation.

In general, Section 203 defines an interested shareholder as any entity or person beneficially owning 15% or more of the outstanding voting stock of the corporation and any entity or person affiliated with or

controlling or controlled by such entity or person.

Transfer Agent

The Transfer Agent and Registrar for our Class A common stock is Computershare Investor Services, LLC.

Table of Contents

DESCRIPTION OF WARRANTS

We may issue warrants to purchase debt securities, Class A common stock or preferred stock, collectively, referred to as the underlying warrant securities, and such warrants may be issued independently or together with any such underlying warrant securities and may be attached to or separate from such underlying warrant securities. Each series of warrants will be issued under a separate warrant agreement to be entered into between us and a warrant agent. The warrant agent will act solely as our agent in connection with the warrants of such series and will not assume any obligation or relationship of agency for or with holders or beneficial owners of warrants.

The applicable prospectus supplement will describe the specific terms of any warrants offered thereby, including:

- the title or designation of such warrants;
- the aggregate number of such warrants;
- the price or prices at which such warrants will be issued;
- the currency or currencies, including composite currencies or currency units, in which the exercise price of such warrants may be payable;
- the designation, aggregate principal amount and terms of the underlying warrant securities purchasable upon exercise of such warrants, and the procedures and conditions relating to the exercise of the warrant securities;
- the price at which the underlying warrant securities purchasable upon exercise of such warrants may be purchased;

the date on which the right to exercise such warrants shall commence and the date on which such right shall expire;

whether such warrants will be issued in registered form or bearer form;

if applicable, the minimum or maximum amount of such warrants which may be exercised at any one time;

if applicable, the designation and terms of the underlying warrant securities with which such warrants are issued and the number of such warrants issued with each such underlying warrant security;

if applicable, the currency or currencies, including composite currencies or currency units, in which any principal, premium, if any, or interest on the underlying warrant securities purchasable upon exercise of the warrant will be payable;

if applicable, the date on and after which such warrants and the related underlying warrant securities will be separately transferable;

information with respect to book-entry procedures, if any;

if necessary, a discussion of certain federal income tax considerations; and

any other terms of such warrants, including terms, procedures and limitations relating to the exchange and exercise of such warrants.

Table of Contents

RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our ratio of earnings to fixed charges[(1)] for the periods indicated:

	Year Ended December 31,				
	2001	2002	2003	2004	2005
Ratio of Earnings to Fixed Charges	23.67	25.75	35.49	59.24	81.12

(1) The ratio of earnings to fixed charges is calculated by dividing earnings, as defined, by fixed charges, as defined. For this purpose, earnings consist of income before income taxes, plus fixed charges and fixed charges consist of interest incurred and the interest portion of rent expense.

LEGAL MATTERS

Unless otherwise indicated in the applicable prospectus supplement or other offering material, Kathleen M. Cronin, our General Counsel, and/or Skadden, Arps, Slate, Meagher & Flom LLP, Chicago, Illinois, will pass upon certain legal matters for us in connection with the securities offered by this prospectus. As of February 17, 2006, Kathleen M. Cronin beneficially owned 1,912 shares of our Class A Common Stock, including options exercisable within 60 days of February 10, 2006 to purchase 160 shares of our Class A Common Stock.

Underwriters, dealers or agents, if any, who we will identify in the applicable prospectus supplement and other offering material, may have their counsel pass upon certain legal matters in connection with the securities offered by this prospectus.

EXPERTS

The consolidated financial statements of Chicago Mercantile Exchange Holdings Inc. incorporated by reference in Chicago Mercantile Exchange Holdings Inc. s Annual Report (Form 10-K) for the year ended December 31, 2005 (including the schedules

appearing therein), and Chicago Mercantile Exchange Holdings Inc. management s assessment of the effectiveness of internal control over financial reporting as of December 31, 2005 included therein, have been audited by Ernst & Young LLP, independent registered public accounting firm, as set forth in their reports thereon, included therein, and incorporated herein by reference. Such consolidated financial statements and management s assessment are incorporated herein by reference in reliance upon such reports given on the authority of such firm as experts in accounting and auditing.

Table of Contents

$750,000,000

CME Group Inc.

5.75% Notes due 2014

Prospectus Supplement

February 4, 2009

Joint-Book Running Managers

Banc of America Securities LLC

UBS Investment Bank

Barclays Capital

Lloyds TSB Corporate Markets

Joint Lead Managers

BMO Capital Markets

Mitsubishi UFJ Securities

Co-Managers

Scotia Capital

PNC Capital Markets LLC