

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

FORM 10 - Q

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

For the quarterly period ended June 30, 2013

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**

(State or other jurisdiction of incorporation)

**88-0425691**

(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  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

(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

As of August 6, 2013, the Registrant had 9,324,783 shares outstanding of its \$.01 par value common stock.

**Quarterly Report on FORM 10-Q  
For The Quarterly Period Ended  
June 30, 2013**

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

- ASSETS -

	June 30, 2013 (Unaudited)	December 31, 2012
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 8,645,392	\$ 2,951,859
Accounts receivable, net of allowance for doubtful accounts of \$24,000 and \$58,000 at June 30, 2013 and December 31, 2012, respectively	3,894,207	4,821,357
Inventories	3,848,295	2,488,071
Prepaid expenses and other current assets	730,383	747,463
<b>TOTAL CURRENT ASSETS</b>	<b>17,118,277</b>	<b>11,008,750</b>
<b>FIXED ASSETS</b> , net of accumulated depreciation	1,832,570	1,427,646
<b>OTHER ASSETS:</b>		
Deferred tax asset, net of valuation allowance	4,197,113	4,233,194
License agreements, net of current portion	350,000	400,000
Deposits on manufacturing equipment	1,975	223,584
Deposits and other assets	41,976	41,976
<b>TOTAL ASSETS</b>	<b>\$ 23,541,911</b>	<b>\$ 17,335,150</b>
<b>- LIABILITIES AND STOCKHOLDERS' EQUITY -</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable and accrued liabilities	\$ 3,929,431	\$ 3,303,923
Current portion of loans payable	-	51,236
Customer deposits	-	23,224
<b>TOTAL CURRENT LIABILITIES</b>	<b>3,929,431</b>	<b>3,378,383</b>
<b>OTHER LIABILITIES:</b>		
Loans payable - net of current portion	-	82,247
<b>TOTAL LIABILITIES</b>	<b>3,929,431</b>	<b>3,460,630</b>
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock – 10,000,000 shares authorized, none outstanding	-	-
Common stock - \$.01 par value; 100,000,000 shares authorized, 9,324,783 and 8,036,232 shares issued and outstanding for June 30, 2013 and December 31, 2012, respectively	93,248	80,362
Additional paid-in capital	46,765,088	41,116,149
Accumulated deficit	(27,245,856)	(27,321,991)
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>19,612,480</b>	<b>13,874,520</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 23,541,911</b>	<b>\$ 17,335,150</b>

*See accompanying notes to condensed consolidated financial statements*

**CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)

	For the three months ended		For the six months ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
<b>REVENUES:</b>				
Net product sales	\$ 5,061,691	\$ 5,811,190	\$ 11,374,881	\$ 12,174,342
License and royalty revenue				
R&D, milestone and grant revenue	<u>331,831</u>	<u>272,701</u>	<u>696,794</u>	<u>562,801</u>
<b>TOTAL REVENUES</b>	<b>5,393,522</b>	<b>6,083,891</b>	<b>12,071,675</b>	<b>12,737,143</b>
Cost of product sales	<u>3,112,347</u>	<u>3,513,267</u>	<u>7,096,610</u>	<u>6,833,656</u>
<b>GROSS MARGIN</b>	<b><u>2,281,175</u></b>	<b><u>2,570,624</u></b>	<b><u>4,975,065</u></b>	<b><u>5,903,487</u></b>
<b>OPERATING EXPENSES:</b>				
Research and development expenses	<u>1,500,645</u>	<u>979,044</u>	<u>2,545,904</u>	<u>2,358,174</u>
Selling, general and administrative expenses	<u>1,160,256</u>	<u>1,079,201</u>	<u>2,322,336</u>	<u>2,313,169</u>
	<u>2,660,901</u>	<u>2,058,245</u>	<u>4,868,240</u>	<u>4,671,343</u>
<b>INCOME (LOSS) FROM OPERATIONS</b>	<b><u>(379,726)</u></b>	<b><u>512,379</u></b>	<b><u>106,825</u></b>	<b><u>1,232,144</u></b>
<b>OTHER INCOME (EXPENSE):</b>				
Gain on sale of fixed asset	7,500	-	7,500	-
Interest income	897	1,598	2,235	3,117
Interest expense	-	<u>(2,317)</u>	<u>(335)</u>	<u>(4,758)</u>
	<u>8,397</u>	<u>(719)</u>	<u>9,400</u>	<u>(1,641)</u>
<b>INCOME (LOSS) BEFORE INCOME TAXES</b>	<b>(371,329)</b>	<b>511,660</b>	<b>116,225</b>	<b>1,230,503</b>
Income tax provision (benefit)	<u>(130,340)</u>	<u>203,130</u>	<u>40,090</u>	<u>488,530</u>
<b>NET (LOSS) INCOME</b>	<b><u>\$ (240,989)</u></b>	<b><u>\$ 308,530</u></b>	<b><u>\$ 76,135</u></b>	<b><u>\$ 741,973</u></b>
<b>Basic earnings (loss) per share</b>	<b><u>\$ (0.03)</u></b>	<b><u>\$ 0.04</u></b>	<b><u>\$ 0.01</u></b>	<b><u>\$ 0.09</u></b>
<b>Diluted earnings (loss) per share</b>	<b><u>\$ (0.03)</u></b>	<b><u>\$ 0.04</u></b>	<b><u>\$ 0.01</u></b>	<b><u>\$ 0.09</u></b>
<b>Weighted average number of shares outstanding, basic</b>	<b><u>9,259,506</u></b>	<b><u>7,987,105</u></b>	<b><u>8,664,478</u></b>	<b><u>7,960,714</u></b>
<b>Weighted average number of shares outstanding, diluted</b>	<b><u>9,259,506</u></b>	<b><u>8,525,199</u></b>	<b><u>9,230,840</u></b>	<b><u>8,512,770</u></b>

*See accompanying notes to condensed consolidated financial statements*

**CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX MONTHS ENDED**  
**(Unaudited)**

	<u>June 30, 2013</u>	<u>June 30, 2012</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Cash received from customers and grants	\$ 12,998,825	\$ 13,520,115
Cash paid to suppliers and employees	(12,197,954)	(11,733,120)
Interest received	2,235	3,117
Interest paid	(335)	(4,758)
<b>Net cash provided by operating activities</b>	<b><u>802,771</u></b>	<b><u>1,785,354</u></b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisition of and deposits on fixed assets	(415,649)	(447,621)
<b>Net cash used in investing activities</b>	<b><u>(415,649)</u></b>	<b><u>(447,621)</u></b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from option and warrant exercises	31,432	84,897
Proceeds from sale of common stock, net	5,512,500	-
Expenses from sale of common stock	(104,038)	-
Payment of loan obligation	(133,483)	(28,967)
Payment of capital lease obligation	-	(14,576)
<b>Net cash provided by financing activities</b>	<b><u>5,306,411</u></b>	<b><u>41,354</u></b>
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>5,693,533</b>	<b>1,379,087</b>
Cash and cash equivalents - beginning of the period	<u>2,951,859</u>	<u>3,010,954</u>
<b>Cash and cash equivalents - end of the period</b>	<b><u>\$ 8,645,392</u></b>	<b><u>\$ 4,390,041</u></b>
<b>RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>		
<b>Net Income</b>	<b>\$ 76,135</b>	<b>\$ 741,973</b>
Adjustments:		
Depreciation and amortization	282,334	269,896
Provision for deferred taxes	36,081	439,677
(Recovery of) doubtful accounts	(34,000)	-
Share based compensation	221,931	179,253
Changes in assets and liabilities:		
Accounts receivable	961,150	782,972
Inventories	(1,360,224)	(841,036)
Prepaid expenses and other current assets	17,080	(54,565)
Accounts payable and accrued liabilities	625,508	(149,233)
Customer deposits and deferred revenue	(23,224)	415,919
<b>Net cash provided by operating activities</b>	<b><u>\$ 802,771</u></b>	<b><u>\$ 1,785,354</u></b>
<b>Supplemental disclosures for non-cash investing and financing activities:</b>		
Deposits on manufacturing equipment transferred to fixed assets	\$ 294,813	\$ 55,794

*See accompanying notes to condensed consolidated financial statements*

**CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2013**  
**(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 main 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. Lateral Flow Rapid HIV tests represented 80 % of the Company's product revenues in the first six months of 2013. The Company's products based on its patented Dual Path Platform (DPP®) platform represented approximately 16 % of the Company's product revenues in the first six months of 2013. The Company also has other rapid tests that together represented approximately 4 % of sales in the first six months of 2013. The Company's products are sold to medical laboratories and hospitals, governmental and public health entities, non-governmental organizations, medical professionals and retail establishments 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 is owned by Alere, 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 products that are currently being developed are based on its patented DPP®, which is a unique diagnostic point-of-care platform that has certain advantages over lateral flow technology. In December 2012, the Company received FDA approval for its DPP® HIV 1/2 Assay for the detection of HIV antibodies in saliva, whole blood, serum and plasma samples.

**NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

**a) Basis of Presentation:**

The preceding (a) condensed consolidated balance sheet as of December 31, 2012, which has been derived from audited financial statements, and (b) the unaudited interim condensed consolidated financial statements as of June 30, 2013 and for the six-month periods ended June 30, 2013 and 2012, respectively, 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, 2012, previously filed with the SEC.

On May 30, 2012, the Company effected a 1-for-8 reverse split of its common stock. This was done to allow the Company to move to the NASDAQ trading market from the QTCQB market, which occurred on June 7, 2012. As a result of the reverse stock split, the outstanding 63,967,263 common shares were reduced to 7,995,918 outstanding common shares on May 30, 2012. The effect of the reverse stock split has been retroactively reflected for all periods in these financial statements.

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 June 30, 2013, its condensed consolidated results of operations for the three- and six-month periods ended June 30, 2013 and 2012, respectively, and its condensed consolidated cash flows for the six-month periods ended June 30, 2013 and 2012, 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.

**CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2013**  
**(UNAUDITED)**

**b) Revenue Recognition**

The Company recognizes revenue for product sales in accordance with ASC 605, which provides that 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. As of June 30, 2013 and December 31, 2012, all advanced revenues were earned.

The Company follows Financial Accounting Standards Board ("FASB") authoritative guidance ("guidance") prospectively for the recognition of revenue under the milestone method. The Company applies the milestone method of revenue recognition for certain collaborative research projects defining milestones at the inception of the agreement.

**c) Inventories:**

Inventories consist of the following at:

	June 30, 2013	December 31, 2012
<b>Raw materials</b>	\$ 1,794,792	\$ 1,418,071
<b>Work in process</b>	902,718	561,530
<b>Finished goods</b>	1,150,785	508,470
	<u>\$ 3,848,295</u>	<u>\$ 2,488,071</u>

**d) Earnings Per Share:**

On May 30, 2012, the Company effected a 1-for-8 reverse split of its common stock. This was done to allow the Company to move to the NASDAQ trading market from the OTCQB market, which occurred on June 7, 2012. As a result of the stock split, the outstanding 63,967,263 common shares were reduced to 7,995,918 outstanding common shares on May 30, 2012. The effect of the reverse stock split has been retroactively reflected for all periods in these financial statements.

Basic earnings per share is computed by dividing net income or loss by the weighted-average number of common shares outstanding for the period. Diluted income per share reflects the potential dilution from the exercise or conversion of other securities into common stock, but only if dilutive. The following securities, presented on a common share equivalent basis for the three and six-month periods ended June 30, 2013 and 2012, have been included in the earnings per share computations:

	For the three months ended		For the six months ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
<b>Basic</b>	9,259,506	7,987,105	8,664,478	7,960,714
<b>Diluted</b>	9,259,506	8,525,199	9,230,840	8,512,770

The following securities, presented on a common share equivalent basis for the three and six-month periods ended June 30, 2013 and 2012, have been included in the diluted per share computations as the exercise prices of these securities were less than the stock price as of June 30, 2013 and 2012, respectively:

	For the three months ended		For the six months ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
<b>1999 and 2008 Plan Stock Options</b>	532,523	538,094	566,362	552,056

**CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2013**  
**(UNAUDITED)**

There were 169,662 and 99,594 options outstanding as of June 30, 2013 and 2012, respectively, that were not included in the calculation of diluted per common share equivalent for the three and six months ended June 30, 2013 and 2012, respectively, because the effect would have been anti-dilutive as of June 30, 2013 and 2012, respectively.

**e) Employee Stock Option Plan:**

The Company had a 1999 Stock Option Plan ("SOP"). The total number of options available under the SOP was 375,000. As of June 30, 2013, there were 93,750 outstanding options under this SOP. No additional options may be issued under the SOP because it is more than 10 years after its adoption.

Effective June 3, 2008, the Company's stockholders voted to approve the 2008 Stock Incentive Plan ("SIP"), initially with 625,000 shares of Common Stock available to be issued. At the Annual Stockholder meeting on September 22, 2011, the Company's stockholders voted to approve an increase to the shares of Common Stock issuable under the SIP by 125,000 to 750,000. 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 and the number of shares of common stock to be covered by each grant. 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 June 30, 2013, there were 144,220 options exercised, 562,648 options outstanding and 43,132 options or shares still available to be issued under the SIP.

The weighted average estimated fair value, at their respective dates of grant, of stock options granted in the three- and six-month periods ended June 30, 2013 and 2012 was \$5.39 and \$2.80 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 based on historical information.

The assumptions made in calculating the fair values of options granted during the periods indicated are as follows (no options issued in the three months ended June 30, 2012):

	<b>For the three months ended</b>		<b>For the six months ended</b>	
	<b>June 30, 2013</b>	June 30, 2012	June 30, 2013	June 30, 2012
<b>Expected term (in years)</b>	3.5	n/a	3	5
<b>Expected volatility</b>	93.80 %	n/a	93.80 % - 101.30 %	115.77 %
<b>Expected dividend yield</b>	0 %	n/a	0 %	0 %
<b>Risk-free interest rate</b>	0.34 %	n/a	0.34 % - 0.40 %	0.36 %

The Company's results for the three-month periods ended June 30, 2013 and 2012 include share-based compensation expense totaling \$84,000 and \$44,000, respectively. Such amounts have been included in the Condensed Consolidated Statements of Operations within cost of goods sold (\$26,000 and \$5,000, respectively), research and development (\$22,000 and \$9,000, respectively) and selling, general and administrative expenses (\$36,000 and \$30,000, respectively). The results for the six-month periods ended June 30, 2013 and 2012 include share-based compensation expense totaling \$222,000 and \$177,000, respectively.

Such amounts have been included in the Condensed Consolidated Statements of Operations within cost of goods sold (\$56,000 and \$20,000, respectively), research and development (\$62,000 and \$57,000, respectively) and selling, general and administrative expenses (\$104,000 and \$100,000, respectively). The income tax benefit has been recognized in the statement of operations for share-based compensation arrangements.

Stock option compensation expense for the three and six-month periods ended June 30, 2013 and 2012 is based on the estimated fair value, at the date of issuance, of options outstanding, which is being amortized on a straight-line basis over the requisite service period for each vesting portion of the award, except for those that vested immediately and for which the estimated fair value was expensed immediately.

**CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2013**  
**(UNAUDITED)**

The following table provides stock option activity for the six months ended June 30, 2013:

Stock Options	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
<b>Outstanding at December 31, 2012</b>	731,646	\$ 2.23	2.19 years	\$ 3,460,686
Granted	51,360	\$ 5.39		
Exercised	(117,380)	\$ 1.53		
Forfeited/expired/cancelled	(9,228)	\$ 3.99		
<b>Outstanding at June 30, 2013</b>	<b>656,398</b>	<b>\$ 2.45</b>	<b>2.16 years</b>	<b>\$ 1,698,863</b>
<b>Exercisable at June 30, 2013</b>	<b>446,432</b>	<b>\$ 1.74</b>	<b>1.50 years</b>	<b>\$ 1,535,980</b>

As of June 30, 2013, there was \$282,000 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 2.17 years. The total fair value of stock options vested during the three-month periods ended June 30, 2013 and 2012 was approximately \$174,000 and \$206,000, 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		For the six months ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
<b>Africa</b>	\$ 1,009,899	\$ 442,833	\$ 1,857,221	\$ 1,520,569
<b>Asia</b>	31,353	254,003	50,619	266,481
<b>Europe</b>	69,324	7,753	76,929	33,331
<b>North America</b>	2,464,060	2,545,376	5,285,578	5,266,136
<b>South America</b>	1,487,055	2,561,225	4,104,534	5,087,825
	<b>\$ 5,061,691</b>	<b>\$ 5,811,190</b>	<b>\$ 11,374,881</b>	<b>\$ 12,174,342</b>

**CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2013**  
**(UNAUDITED)**

**g) Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities consist of:

	<u>June 30, 2013</u>	<u>December 31, 2012</u>
Accounts payable – suppliers	\$ 1,992,452	\$ 1,686,431
Accrued commissions	154,119	238,150
Accrued royalties / license fees	761,986	583,923
Accrued payroll	244,821	262,439
Accrued vacation	257,179	181,636
Accrued bonuses	325,500	155,663
Accrued expenses – other	193,374	195,681
<b>TOTAL</b>	<u>\$ 3,929,431</u>	<u>\$ 3,303,923</u>

**NOTE 3 — COLLABORATIVE RESEARCH AND DEVELOPMENT ARRANGEMENTS:**

**a) National Institutes of Health (NIH) Grant:**

In June 2009, the Company received a \$2.8 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 0 and \$363,000 for the six-month periods ended June 30, 2013 and 2012, respectively from this grant. The Company earned an aggregate of \$2,756,000 from this grant from inception through June 30, 2013, of which \$898,000 was paid to sub-contractors.

In March 2011, the Company received a \$2.9 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 \$331,000 and \$252,000 for the six-month periods ended June 30, 2013 and 2012, respectively from this grant. The Company earned \$2,014,000 from this grant from inception through June 30, 2013 of which \$651,000 was paid to sub-contractors.

**b) Battelle/CDC DPP® Influenza Immunity Test:**

In July 2012, the Company entered into a follow-on, milestone-based development agreement of up to \$480,000 based on Chembio's previous successful initial development of a multiplex rapid point-of-care ("POC") influenza immunity test utilizing its patented Dual Path Platform (DPP®) technology. The agreement contemplates a period of approximately nine months in which the follow-on development activity is to be completed. The Company earned \$265,000 and 0 for the six-month periods ended June 30, 2013 and 2012, respectively from this agreement. The Company earned \$542,000 from this grant from inception through June 30, 2013.

**NOTE 4 — LOANS PAYABLE:**

On April 30, 2013, the Company entered into a new demand loan agreement ("Demand Note") with HSBC Bank, USA ("HSBC"). The Demand Note allows the Company to draw on the line from time to time an amount up to an aggregate of \$2,000,000 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 for which the bank lender can demand repayment of the entire loan, with accrued interest, at any time. The loan is subject to annual reviews, as well as an annual 30-day clean-up, during which there can be no amounts outstanding.

**CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY**  
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The Security Agreement, related to the Demand Note, contains covenants that place 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, and restrictions on fundamental changes in the Company and in its business.

The Company currently maintains its operating, payroll, and primary cash accounts at HSBC. As of June 30, 2013, nothing had been drawn down on the Demand Note.

**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, which is defined below. Until a Right is exercised, the holder thereof, in his capacity as a holder of Rights, 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").

**NOTE 6 — COMMON STOCK, WARRANTS AND OPTIONS:**

The Company entered into an employment agreement effective May 22, 2013 ("Employment Agreement"), with Ms. Klugewicz to serve as the Company's Chief Operating Officer, which included issuing incentive stock options to purchase 5,000 shares of the Company's common stock. Of these stock options, options to purchase 2,500 shares vest on each of the first two anniversaries of the effective date of the Employment Agreement. The exercise price for these options was to be equal to the last traded price for the Company's common stock on May 22, 2013, which was \$4.50 per share. Each option granted will expire and terminate, if not exercised sooner, upon the earlier to occur of (a) 30 days after termination of the employee's employment with the Company or (b) the fifth anniversary of the effective date of the grant.

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The Company closed on an underwritten public offering of 1,200,000 shares of its common stock at \$5.00 per share on April 3, 2013. The net proceeds of the offering, after deducting the underwriters' discounts and other estimated offering expenses payable by the Company, was approximately \$5,401,000. The Company intends to use the net proceeds for business expansion and working capital.

On February 26, 2013, the Company issued 16,360 options to purchase common stock to executives of the Company as part of their 2012 bonus. The options are exercisable immediately at \$5.56 per share, which was the last traded price of the common stock on that day, and they expire five years from the date of issue.

The Company entered into an employment agreement effective March 5, 2013 ("Employment Agreement"), with Mr. Esfandiari to continue as the Company's Senior Vice President of Research and Development, which included issuing incentive stock options to purchase 30,000 shares of the Company's common stock. Of these stock options, options to purchase 10,000 shares vest on each of the first three anniversaries of the effective date of the Employment Agreement. The exercise price for these options was to be equal to the last traded price for the Company's common stock on March 5, 2013, which was \$5.44 per share. Each option granted will expire and terminate, if not exercised sooner, upon the earlier to occur of (a) 30 days after termination of the employee's employment with the Company or (b) the fifth anniversary of the effective date of the grant.

As of June 30, 2013, the Company had no warrants outstanding to purchase shares of common stock.

**NOTE 7 — COMMITMENTS, CONTINGENCIES, AND CONCENTRATIONS:**

**a) Economic Dependency:**

The following table discloses product sales the Company had to each customer that purchased in excess of 10% of the Company's net product sales for the periods indicated:

	<u>For the three months ended</u>				<u>For the six months ended</u>				<u>Accounts Receivable As of</u>	
	<u>June 30, 2013</u>		<u>June 30, 2012</u>		<u>June 30, 2013</u>		<u>June 30, 2012</u>		<u>June 30,</u>	<u>June 30,</u>
	<u>Sales</u>	<u>% of Sales</u>	<u>Sales</u>	<u>% of Sales</u>	<u>Sales</u>	<u>% of Sales</u>	<u>Sales</u>	<u>% of Sales</u>	<u>2013</u>	<u>2012</u>
Customer 1	\$ 2,305,729	46	\$ 2,144,051	37	\$ 4,895,683	43	\$ 4,592,906	38	\$ 905,829	\$ 619,969
Customer 2	650,221	13	2,383,025	41	1,869,096	16	4,899,025	40	712,950	597,984
Customer 3	868,869	17	*	*	2,058,006	18	*	*	856,884	*
Customer 4	664,944	13	*	*	1,127,933	10	*	*	549,263	*

(\*) Product sales did not exceed 10 % for the period indicated.

Note that sales include product sales only while accounts receivable reflects the total due from the customer, which includes freight.

**CHEMBIO DIAGNOSTICS, INC. AND SUBSIDIARY**  
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**JUNE 30, 2013**

**(UNAUDITED)**

The following table discloses purchases the Company made from each vendor that sold to the Company in excess of 10% of the Company's total purchases for the periods indicated:

	For the three months ended				For the six months ended				Accounts Payable As of	
	June 30, 2013		June 30, 2012		June 30, 2013		June 30, 2012		June 30, 2013	June 30, 2012
	Purchases	% of Purc.	Purchases	% of Purc.	Purchases	% of Purc.	Purchases	% of Purc.		
Vendor 1	\$ 131,445	12	\$ 231,043	13	\$ 376,117	6	\$ 408,679	13	\$ 88,440	\$ 67,945
Vendor 2	239,539	6	237,550	13	565,384	9	378,204	12	129,042	29,805

(\*) Purchases did not exceed 10% for the period indicated

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 three key employees. The contracts call for salaries presently aggregating \$840,000 per year. The Klugewicz contract expires in May 2015, the Esfandiari contract expires in March 2016 and the Siebert employment contract expires in May 2014. In connection with the contract that expires in May 2015, the Company issued, in May 2013, 5,000 options to purchase common stock, with one-half vesting on each of the first and second anniversaries of the grant and in connection with the contract that expires in March 2016, the Company issued, in March 2013, 30,000 options to purchase common stock, with one-third vesting on each of the first, second and third anniversaries of the grant.

**NOTE 8 — INCOME TAXES:**

The Company's interim provision for income taxes is measured using an estimated annual effective tax rate of 35.1 % based on the 2012 statements. As per IRS rules, only 90 % of the taxable income can be offset by NOLs, and therefore 3.5 %, or \$401, was added to accrued expenses, 35.1 %, or \$40,090, was expensed, and the balance of 31.6 %, or \$39,689, reduced the carrying value of the deferred tax asset for the three months ended June 30, 2013.

## 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 as 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 are 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 have not changed significantly from December 31, 2012.

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," "anticipates," "believes," "estimates," "predicts," "potential," "continues" or the negative of these terms or other comparable terminology. 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.

All of the Company's future products 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. The Company has completed development of several products that employ the DPP® technology, three of which will be marketed under Chembio's label (DPP® HIV 1/2 Screening Assay, DPP® Syphilis Screen & Confirm, and DPP® HIV 1/2 –Syphilis Assay) and several others that have been developed specifically related to private label agreements with The Oswaldo Cruz Foundation ("FIOCRUZ") for the Brazilian public health market, as explained below.

All of the Company's products other than its lateral flow tests are based on the Company's patented Dual Path Platform (DPP®) technology. The Company has had very active research and development programs and has significantly increased its spending on research and development during the last three years. Third-party funding from research and development contracts and grants have offset a significant portion of these increased research and development expenses. The Company has a number of products under development that employ the DPP® technology. The principal product development activities are described below.

**DPP® Hepatitis-C (HCV) Antibody Detection and HCV Antigen-Antibody Multiplex Test** – Development work on our DPP® HCV point-of-care rapid test continues. Our development activity has been focused on creating a differentiated product that is at least capable of identifying antibody response in a more comprehensive manner than the currently available point-of-care test is able to do, and to also, in parallel, engage in efforts to differentiate those patients that are antibody positive from those that have an active infection, as up to 30% of patients that are HCV antibody-positive don't have an active infection.

In July 2012, the U.S. Centers for Disease Control finalized the recommendations for testing all individuals in the United States born between the years of 1945 and 1965 for HCV, which age cohort represents a substantial portion of the estimated over three million individuals in the United States that are infected with HCV infection but unaware of their status. With a number of new anti-retroviral therapies approved, and even more pending approval in the years ahead by the FDA, we believe that over time these new recommendations will be implemented. In fact, in May the United States Preventive Services Task Force revised its

November 2012 recommendations to more fully endorse the CDC recommendations by giving both hepatitis-C (HCV) screening for at-risk individuals and age-cohort screening a 'B' grade; under the Affordable Care Act, preventive services that have received an 'A' or 'B' grade from the USPSTF must be covered by insurance policies without cost-sharing and be part of the essential health benefits for those individuals eligible for Medicare.

We plan to complete development in mid-2014, and to begin commercialization activities in the US. by the end of 2015 or early 2016.

**DPP® HIV Multiplex Antigen-Antibody Test** - Development work continues on a DPP® HIV multiplex test that is being designed to detect acute (early stage) HIV infection by means of detecting P24 antigen, as well as antibodies, to HIV1/2, in whole blood samples. There are no FDA-approved point-of-care tests that detect acute HIV infection, although there are two FDA- approved laboratory tests with such claims, and Alere anticipates near-term approval of its Determine HIV Ag/AB test that we expect will claim earlier detection due to the ability to detect unbound P-24 antigen. We believe that development of such a test in our patented DPP® point-of-care platform may help identify HIV infections that cannot currently be identified by any of the currently FDA-approved rapid HIV tests or the new Alere Determine test, and thus serve an unmet market need and may help to maintain and potentially grow the already strong position our products have in the U.S. rapid HIV test market.

Our revised plan for the new HCV and HIV products is to complete development of these products by mid-2014, conduct clinical trials in 2014-2015, and to receive FDA approval by the end of 2015 or early 2016.

**International Distribution & Assembly Agreement with Labtest** - During the second quarter the Company entered into an international assembly and distribution agreement with Labtest Diagnostica SA (Labtest), a leading diagnostics manufacturer and marketing organization based in Brazil, for products based upon Chembio's patented Dual Path Platform (DPP®) in Brazil and potentially other markets outside the U.S. Pursuant to the agreement, Chembio will manufacture and sell certain specialized test components to Labtest and also will receive a royalty based on sales by Labtest of DPP® products. Labtest will produce certain reagents and perform assembly and packaging operations in a dedicated space at Labtest's manufacturing facilities near Belo Horizonte, Brazil. Chembio will provide Labtest with the training necessary to perform the operations specific to the DPP® products. Labtest will also have responsibility for marketing, promotion and distribution of the products in Brazil.

All products will be marketed under brand names that will include Chembio's DPP® trademark together with trade names selected by Labtest, and each test kit will state that Chembio Diagnostic Systems, Inc. is the licensor of the DPP® trademark and technology. The products selected for inclusion in this agreement will address both private as well as public health markets, and will enable Chembio to participate in significant market opportunities in Brazil. This agreement addresses market opportunities that are independent of those addressed by Chembio's ongoing collaboration with the Oswaldo Cruz Foundation.

Chembio and Labtest will immediately begin product registration activities for an initial group of infectious disease products with sales expected to commence by early 2014. The agreement contemplates additional products and territories to be added by mutual agreement. In addition, the agreement offers the possibility for Labtest to assemble products for other global Chembio customers as a contract manufacturer.

## ***Sponsored Research & Development***

**Multiplex Influenza Immunity Test** – In July 2012 we entered into a follow-on, milestone-based development agreement of up to \$480,000 based on our previous successful initial development of a multiplex rapid point-of-care ("POC") influenza immunity test utilizing our patented Dual Path Platform (DPP®) technology. The agreement contemplated a period of approximately six months in which the follow-on development activity was to be completed. In the first quarter of 2013 we completed the requirements of this agreement.

During the second quarter we reported that the Company had entered into a follow-on, milestone-based development agreement with the private contracting organization that is engaged to enter into, implement and provide technical oversight of agreements relating to pandemic influenza preparedness on behalf of its client, the United States Centers for Disease Control and Prevention (CDC), for a multiplex, rapid, POC influenza immunity test utilizing Chembio's patented Dual Path Platform (DPP®) technology. The follow-on agreement is for up to approximately \$472,000 and contemplates a period of approximately six months, or May through October of 2013, in which the follow-on development activity is to be completed.

The early prototype development work for this product was successfully completed by Chembio in 2010 through 2013 pursuant to previous contracts with the same organization totaling approximately \$1.4 million. The objective of this follow-on project is to further develop a rapid influenza immunity test that can determine a person's influenza immunity status in the field or in an outpatient setting, while incorporating certain additional subunits of influenza virus proteins.

As a result of pandemic planning activities, the United States Department of Health and Human Services and the CDC have identified POC and high-throughput testing as a gap in influenza diagnostics. Rapid responses in the field — such as the vaccination, prophylactic treatment or isolation of patients — require POC diagnostic tests for influenza infection and immunity. Ideally, these tests should be fast, portable, self-contained and non-technical. Development of this test is especially critical for the military, as evidenced by previous influenza outbreaks that spread rapidly through densely populated barracks and killed thousands of soldiers.

**DPP® Febrile Illness Multiplex test** – During the second quarter we entered into a cooperative research project agreement with a U.S. government agency for up to \$750,000 for an eight-month development project. The project is to develop a rapid POC diagnostic test for five infectious diseases associated with febrile illness and to multiplex them into one assay. The project also contemplates that the test would be optimized for use with a mobile reader that incorporates cell phone technology to enable the results to be recorded, transmitted and monitored remotely via a cloud system, in real-time. This research project supports our efforts in developing multiplex products using our proprietary DPP® technology. Our DPP® technology, when combined with the mobile reader being used in the project, will enable real time data collection and monitoring capabilities. As these infectious diseases can all exhibit similar clinical symptoms, a rapid multiplex test that could distinguish them would be very useful, particularly in field conditions, so that correct diagnosis and treatment could be provided on a timely basis.

**DPP® Tuberculosis** – 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 our successful Phase I grant work to develop a simple, rapid, accurate, and cost-effective serological test for active tuberculosis that can be utilized in resource-limited settings. During 2012, several additional antigens were identified to enhance antibody detection by the DPP® test prototype designed in our Phase I studies. Antigen reagents have been finalized and test prototype evaluation using well-characterized clinical specimens is in progress. Funding for the third and final year of this Phase II grant was confirmed with a reduction of approximately 1%.

Chembio's work to finalize DPP assay design using various fusion proteins has been completed and production of an evaluation lot is in progress; these tests will be used for verification studies, internal and external evaluations at the selected collaborative sites (see below), QC protocol validation, and accelerated stability study. The target sensitivity is 80% and specificity is 95%. Study sites for external evaluations of DPP assay include Bangladesh, Brazil, China, Haiti, Peru, Venezuela, and South Africa.

In addition to the above-mentioned research and development work sponsored by governmental agencies and/or their contractors for the influenza, febrile illnesses, and tuberculosis projects, we are discussing additional opportunities for sponsored research and development activity. We endeavor to select sponsored research projects where we believe there is an identifiable commercial opportunity and/or where other benefits to the Company are anticipated in connection with these projects.

In general, we are considering certain new DPP® product opportunities, either as OEM development projects and/or as Chembio-branded products. These products are being identified based upon our assessment of opportunities in the market and upon whether they can be addressed with our proprietary technology, along with our development and manufacturing capabilities and experience. We are also identifying and assessing additional technologies that we believe could provide us with additional products and capabilities, and thereby provide additional revenue streams, although there is no assurance that we will be able to obtain or utilize any of them profitably.

### **Regulatory Activities**

**CE Mark for FDA-approved HIV tests** – The Company's SURE CHECK® HIV 1/2 Assay has received CE Mark approval from European regulators and is therefore now cleared for commercialization within the European Union (EU) for rapid, point-of-care detection of HIV. Chembio is currently working with commercialization partners in Europe. We anticipate that our HIV 1/2 STAT PAK® lateral flow HIV test and our DPP® HIV 1/2 test will receive CE Mark approval in the fall.

**FDA Approval for DPP® HIV 1/2 Screening Assay for Use with oral fluid or blood samples** – We received FDA approval of our Pre-Marketing Application (PMA) for this product on December 19, 2012 as we previously announced. We are now working towards a CLIA waiver, however we now expect that it will not be granted before the end of 2013. As we had reported, we initiated the CLIA study in April, and our plan was to have the submission into the FDA by July, and to receive a CLIA waiver during the fourth quarter. However, start up of certain sites was delayed, so that completion of the trial is also delayed. As of July 31, 2013, approximately 50% of the enrollment criteria had been completed, and the results are in accordance with expected requirements. At this rate, enrollment will be completed by September 2013, as compared with the original expectation of July. Therefore the CLIA waiver is not likely to be submitted until during the fourth quarter and therefore the CLIA waiver grant is now expected to be received in the first quarter of 2014.

**DPP® HIV-Syphilis** – We have developed this product for international and US marketing; Although initial international registrations and approvals are anticipated before the end of 2013, we expect the US FDA approval process to be lengthier (see below). Globally, far more pregnant women are estimated to have syphilis than HIV, and untreated maternal syphilis always results in an adverse pregnancy outcome such as fetal death, stillbirth, premature birth, low birth weight or congenital syphilis infection. As syphilis commonly co-exists in patients with HIV (prevalence is 14-36%), a dual rapid test for HIV and syphilis could greatly strengthen pregnant mother-to-child testing, or PMTCT, of syphilis. This is particularly true, because there are already well financed programs for the PMTCT of HIV.

For the international market we have submitted this product both for evaluation by the CDC, acting on behalf of the United States Agency of International Development, and the WHO, which has accepted this product to be evaluated for pre-qualification in its global procurement scheme. Other international registrations are pending. During the second quarter we announced receipt of an evaluation report from Mexico's Institute of Epidemiological Diagnosis and Reference (InDRE) regarding the Company's DPP® HIV-Syphilis multiplex test, which showed the Company's assay performed with 100% agreement for both markers on all 941 samples tested. In evaluating the sensitivity and specificity of the Chembio DPP® HIV-Syphilis product, 527 biological samples were tested on the HIV line, of which 158 were true negative and 369 were true positive, and 414 were tested on the Syphilis line, of which 108 were true negative and 306 were true positive. The Chembio DPP® HIV-Syphilis test performed with 100% sensitivity and 100% specificity on all samples.

The FDA review timeline for this product, which we originally anticipated would be in mid-2014, has now been shifted to late 2014, with CLIA waiver now anticipated in early 2015. This development is due to this product being characterized by FDA as a PMA, not a 510(K), as the syphilis component performance will be compared to actual patient infection status, as compared to a predicate device allowed in 510(K). This change will be more time consuming due to the increased statutory review time, and potentially more costly.

**DPP® Syphilis Screen & Confirm** - In late February we received a response from the FDA that will enable us to pursue the regulatory pathway that we outlined in our submission. While we confirmed our intended study approach with the FDA, we have encountered problems with the supply of one of the key raw materials used in this test. Until we are able to resolve those problems, this project is on hold.

**SURE CHECK® HIV OTC Study** – We completed the self-testing study required for submitting an IDE ("Investigational Device Exemption") application in order to commence clinical trials for this product. However due to the results reported to date by Orasure, which show significant marketing expenditures without meaningful revenues, let alone the costs of the clinical trials and other costs associated with FDA approval, we will keep this project on hold though we will continue to monitor this market opportunity closely.

*There can be no assurance that any of the aforementioned Research & Development and/or Regulatory products or activities will result in any product approvals or commercialization, nor that any of the existing research and development activities, or any new potential development programs or collaborations will materialize 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.*

### **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 have not changed from December 31, 2012, see our Annual Report on Form 10-K for the twelve months ended December 31, 2012, which was filed with the SEC on March 7, 2013.

**RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2013 AS COMPARED WITH THE THREE MONTHS ENDED JUNE 30, 2012**

**Income:**

For the three months ended June 30, 2013 loss before income taxes was (\$371,000) compared to income before taxes of \$512,000 for the three months ended June 30, 2012. Net income for the 2012 period was \$309,000 as compared to a net loss of (\$241,000) for 2013. The decrease in net income is primarily attributable to a combination of increased operating expenses, especially increased clinical trial expenses attributable to our ongoing CLIA waiver studies, and to decreased product sales. In the three months ended 2013, as a result of a 12.9% decrease in Net Product Sales and a 21.7% increase in non-product revenues along with a 11.4% decrease in cost of products sold, the Company had a \$289,000, or 11.3%, decrease in its gross margin, to \$2,281,000. This decreased gross margin also included increased operating expenses, the most significant of which was an increase in clinical trial expenses of \$350,000, partially offset by a decrease in commissions of \$184,000, due to the decreased sales in Brazil account for most of the change from a net income to a net loss.

**Revenues:**

Selected Product Categories:	For the three months ended		\$ Change	% Change
	June 30, 2013	June 30, 2012		
Lateral Flow HIV Tests and Components	\$ 4,158,354	\$ 3,159,657	\$ 998,697	31.61%
DPP Tests and Components	694,816	2,226,200	(1,531,384)	-68.79%
Other	208,521	425,333	(216,812)	-50.97%
Net Product Sales	<u>5,061,691</u>	<u>5,811,190</u>	<u>(749,499)</u>	<u>-12.90%</u>
License and royalty revenue	-	-	-	100.00%
R&D, milestone and grant revenue	331,831	272,701	59,130	21.68%
Total Revenues	<u>\$ 5,393,522</u>	<u>\$ 6,083,891</u>	<u>\$ (690,369)</u>	<u>-11.35%</u>

Revenues for our lateral flow HIV tests and related components during the three months ended June 30, 2013 increased by approximately \$999,000 from the same period in 2012. This was attributable to increased sales to South America, excluding Brazil, of approximately \$654,000, increased sales to Africa of \$567,000, and increased sales to Alere from \$2,144,000 during the three months ended June 30, 2012 to \$2,306,000 during the three months ended June 30, 2013. These increases were partially offset by decreased sales to Brazil of \$201,000 and decreased sales to Asia of \$223,000. Revenues for our DPP® products during the three months ended June 30, 2013 decreased by approximately \$1,531,000 over the same period in 2012, a decrease of 69%, which decrease is attributable to a reduction in sales to the Oswaldo Cruz Foundation. The increase in R&D, milestone and grant revenue was due to revenue from certain development projects granted in the fourth quarter of 2012. R&D revenues include funds, recognized on an "as expenses are incurred" basis, from a Phase II NIH grant for Leptospirosis, which was effective as of June 1, 2009, and from a Phase II grant for Tuberculosis which was effective March 1, 2011 as well as a development contract with Battelle entered into in the fourth quarter of 2012.

**Gross Margin:**

Gross Margin related to Net Product Sales:	For the three months ended		\$ Change	% Change
	June 30, 2013	June 30, 2012		
Gross Margin per Statement of Operations	\$ 2,281,175	\$ 2,570,624	\$ (289,449)	-11.26%
Less: R&D, milestone, grant, license and royalties	331,831	272,701	59,130	21.68%
Gross Margin from Net Product Sales	<u>\$ 1,949,344</u>	<u>\$ 2,297,923</u>	<u>\$ (348,579)</u>	<u>-15.17%</u>
Product Gross Margin %	<u>38.51%</u>	<u>39.54%</u>		

The gross margin dollar decrease of \$289,000 included a \$349,000 decrease in gross margin from product sales, partially offset by a \$59,000 increase in non-product revenues. The decrease in product gross margin is primarily attributable to the lower product sales compared to 2012 period of \$296,000. The 1% decrease in our product gross margin percentage, from 39.5% in 2012 to 38.5% in 2013, accounted for the \$53,000 balance and was primarily due to increased costs in products overhead application, together with a change in the product sales mix. Some of the product mix change was due to the decreased sales to Brazil as a percentage of overall sales from 38.3% to 13.7%. Partially offsetting these increased costs was a decrease in our scrap expenses as we focused on this area after the higher scrap experienced during 2012.

**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		\$ Change	% Change
	June 30, 2013	June 30, 2012		
<b>Clinical and Regulatory Affairs:</b>				
Wages and related costs	\$ 108,466	\$ 125,956	\$ (17,490)	-13.89%
Consulting	7,463	5,081	2,382	46.88%
Stock-based compensation	3,027	5,268	(2,241)	-42.54%
Clinical trials	421,768	71,845	349,923	487.05%
Other	24,466	19,517	4,949	25.36%
<b>Total Regulatory</b>	<b>565,190</b>	<b>227,667</b>	<b>337,523</b>	<b>148.25%</b>
<b>R&amp;D Other than Regulatory:</b>				
Wages and related costs	538,789	467,570	71,219	15.23%
Consulting	42,326	43,362	(1,036)	-2.39%
Stock-based compensation	19,334	3,080	16,254	527.73%
Materials and supplies	251,716	161,305	90,411	56.05%
Other	83,290	76,060	7,230	9.51%
<b>Total other than Regulatory</b>	<b>935,455</b>	<b>751,377</b>	<b>184,078</b>	<b>24.50%</b>
<b>Total Research and Development</b>	<b>\$ 1,500,645</b>	<b>\$ 979,044</b>	<b>\$ 521,601</b>	<b>53.28%</b>

Expenses for Clinical & Regulatory Affairs for the three months ended June 30, 2013 increased by \$338,000 as compared to the same period in 2012. This was primarily due to an increase of \$350,000 in clinical trial expenses which are mostly associated with CLIA waiver studies for our DPP® HIV 1/2 Assay.

R&D expenses other than Clinical & Regulatory Affairs increased by \$184,000 in the three months ended June 30, 2013, as compared with the same period in 2012. The increases were primarily related to an increase in wages and related costs and in material and supplies to support our sponsored research and internal development programs.

**Selling, General and Administrative Expenses:**

Selected expense lines:	For the three months ended		\$ Change	% Change
	June 30, 2013	June 30, 2012		
Wages and related costs	\$ 452,103	\$ 358,167	\$ 93,936	26.23%
Consulting	100,061	105,432	(5,371)	-5.09%
Commissions	92,002	275,745	(183,743)	-66.64%
Stock-based compensation	34,867	30,078	4,789	15.92%
Marketing materials	22,294	15,710	6,584	41.91%
Investor relations/investment bankers	39,023	73,769	(34,746)	-47.10%
Legal, accounting and compliance	73,587	133,523	(59,936)	-44.89%
Travel, entertainment and trade shows	69,554	37,213	32,341	86.91%
Bad debt allowance (recovery)	-	(95,000)	95,000	-100.00%
Other	276,765	144,564	132,201	91.45%
<b>Total S, G &amp; A</b>	<b>\$ 1,160,256</b>	<b>\$ 1,079,201</b>	<b>\$ 81,055</b>	<b>7.51%</b>

Selling, general and administrative expenses for the three months ended June 30, 2013, increased by \$81,000 as compared with the same period in 2012, a 7.5% increase. Significant increases in wages and related costs, travel, entertainment and trade shows and non-recurrence of a bad debt recovery in 2012 were partially offset by a \$184,000 decrease in commissions due to decreased sales to Brazil along with a decrease in investor relations/investment bankers of \$35,000 and professional expenses of \$60,000.

**Other Income and (Expense):**

	For the three months ended		\$ Change	% Change
	June 30, 2013	June 30, 2012		
Other income (expense)	\$ 7,500	\$ -	\$ 7,500	100.00%
Interest income	897	1,598	(701)	-43.87%
Interest expense	-	(2,317)	2,317	-100.00%
<b>Total Other Income and (Expense)</b>	<b>\$ 8,397</b>	<b>\$ (719)</b>	<b>\$ 9,116</b>	<b>-1267.87%</b>

Other income for the three months ended June 30, 2013 increased approximately \$9,000, to an income of \$8,000 from an expense of \$1,000 in the same period in 2012, primarily as a result of a gain on the sale of a fixed asset and a decrease in interest expense due on the term loan with HSBC.

**RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2013 AS COMPARED WITH THE SIX MONTHS ENDED JUNE 30, 2012****Income:**

Income before income taxes for the six months ended June 30, 2013 decreased to \$116,000 from \$1,231,000 for the six months ended June 30, 2012. Net Income decreased from \$742,000 for 2012 to \$76,000 for 2013. The decrease is primarily attributable to a decrease in Net Product Sales. In 2013, as a result of a 6.6% decrease in Net Product sales and a 23.8% increase in non-product revenues along with a 3.8% decrease in cost of products sold, the Company had a \$928,000, or 16%, decrease in its gross margin, to \$4,975,000. This decreased gross margin along with increased operating expenses, accounted for most of the decrease in net income.

**Revenues:**

Selected Product Categories:	For the six months ended		\$ Change	% Change
	June 30, 2013	June 30, 2012		
Lateral Flow HIV Tests and Components	\$ 9,095,215	\$ 6,927,593	\$ 2,167,622	31.29%
DPP Tests and Components	1,837,651	4,652,200	(2,814,549)	-60.50%
Other	442,015	594,549	(152,534)	-25.66%
Net Product Sales	<b>11,374,881</b>	<b>12,174,342</b>	<b>(799,461)</b>	<b>-6.57%</b>
License and royalty revenue	-	-	-	100.00%
R&D, milestone and grant revenue	696,794	562,801	133,993	23.81%
<b>Total Revenues</b>	<b>\$ 12,071,675</b>	<b>\$ 12,737,143</b>	<b>\$ (665,468)</b>	<b>-5.22%</b>

Revenues for our lateral flow HIV tests and related components during the six months ended June 30, 2013 increased by approximately \$2,168,000 from the same period in 2012. This was attributable to increased sales to South America, excluding Brazil, of \$1,388,000 and increased sales to Alere from \$4,896,000 during the six months ended June 30, 2012 to \$4,593,000 during the six months ended June 30, 2013. These increases were partially offset by decreased sales to Africa of \$230,000. Revenues for our DPP® products during the six months ended June 30, 2013 decreased by approximately \$2,815,000 over the same period in 2012, a decrease of 60.5%, which decrease is attributable to a reduction in sales to the Oswaldo Cruz Foundation. The increase in R&D, milestone and grant revenue was due to revenue from certain development projects granted in the fourth quarter of 2012. R&D revenues include funds, recognized on an "as expenses are incurred" basis, from a Phase II NIH grant for Leptospirosis, which was effective as of June 1, 2009, and from a Phase II grant for Tuberculosis which was effective March 1, 2011 as well as a development contract with Battelle entered into in the fourth quarter of 2012.

**Gross Margin:****Gross Margin related to Net Product Sales:**

	For the six months ended		\$ Change	% Change
	June 30, 2013	June 30, 2012		
<b>Gross Margin per Statement of Operations</b>	\$ 4,975,065	\$ 5,903,487	\$ (928,422)	-15.73%
<b>Less: R&amp;D, milestone, grant, license and royalties</b>	696,794	562,801	133,993	23.81%
<b>Gross Margin from Net Product Sales</b>	<u>\$ 4,278,271</u>	<u>\$ 5,340,686</u>	<u>\$ (1,062,415)</u>	<u>-19.89%</u>
<b>Product Gross Margin %</b>	<u>37.61%</u>	<u>43.87%</u>		

The gross margin dollar decrease of \$928,000 included a \$1,062,000 decrease in gross margin from product sales, partially offset by a \$134,000 increase in non-product revenues. The 6.4% decrease in our product gross margin percentage, from 43.9% in 2012 to 37.6% in 2013, was primarily due to increased costs in our operations support group, incoming freight, overhead costs, together with a change in the product sales mix. Some of the product mix change was due to the decreased sales of DPP as a percentage of overall sales from 38.2% to 16.2%. Partially offsetting these increased costs was a decrease in our scrap expenses as we focused on this area after the higher scrap experienced at the end of 2012.

**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 six months ended		\$ Change	% Change
	June 30, 2013	June 30, 2012		
<b>Clinical and Regulatory Affairs:</b>				
<b>Wages and related costs</b>	\$ 213,957	\$ 249,681	\$ (35,724)	-14.31%
<b>Consulting</b>	25,189	9,331	15,858	169.95%
<b>Stock-based compensation</b>	14,632	20,692	(6,060)	-29.29%
<b>Clinical trials</b>	519,544	555,534	(35,990)	-6.48%
<b>Other</b>	28,544	32,718	(4,174)	-12.76%
<b>Total Regulatory</b>	<u>801,866</u>	<u>867,956</u>	<u>(66,090)</u>	<u>-7.61%</u>
<b>R&amp;D Other than Regulatory:</b>				
<b>Wages and related costs</b>	1,046,583	939,495	107,088	11.40%
<b>Consulting</b>	52,163	48,362	3,801	7.86%
<b>Stock-based compensation</b>	47,641	36,247	11,394	31.43%
<b>Materials and supplies</b>	432,896	316,513	116,383	36.77%
<b>Other</b>	164,755	149,601	15,154	10.13%
<b>Total other than Regulatory</b>	<u>1,744,038</u>	<u>1,490,218</u>	<u>253,820</u>	<u>17.03%</u>
<b>Total Research and Development</b>	<u>\$ 2,545,904</u>	<u>\$ 2,358,174</u>	<u>\$ 187,730</u>	<u>7.96%</u>

Expenses for Clinical & Regulatory Affairs for the six months ended June 30, 2013 decreased by \$66,000 as compared to the same period in 2012. This was primarily due to the reduction of \$36,000 in clinical trial expenses which were mostly associated with clinical studies for our DPP® HIV 1/2 Assay along with a \$36,000 decrease in wages and related costs. The clinical studies for this product were completed during the first half of 2012, while 2013 primarily reflects the CLIA waiver study costs related to this product.

R&D expenses other than Clinical & Regulatory Affairs increased by \$254,000 in the six months ended June 30, 2013, as compared with the same period in 2012, and were primarily related to an increase in wages and related costs and in material and supplies, as well as an increase in stock-based compensation.

**Selling, General and Administrative Expenses:**

Selected expense lines:	For the six months ended		\$ Change	% Change
	June 30, 2013	June 30, 2012		
Wages and related costs	\$ 893,575	\$ 714,836	\$ 178,739	25.00%
Consulting	106,261	169,001	(62,740)	-37.12%
Commissions	251,910	565,239	(313,329)	-55.43%
Stock-based compensation	103,533	100,383	3,150	3.14%
Marketing materials	29,257	26,168	3,089	11.80%
Investor relations/investment bankers	113,886	120,017	(6,131)	-5.11%
Legal, accounting and compliance	313,644	291,700	21,944	7.52%
Travel, entertainment and trade shows	97,305	64,289	33,016	51.36%
Bad debt allowance (recovery)	(33,450)	-	(33,450)	100.00%
Other	446,415	261,536	184,879	70.69%
<b>Total S, G &amp; A</b>	<b>\$ 2,322,336</b>	<b>\$ 2,313,169</b>	<b>\$ 9,167</b>	<b>0.40%</b>

Selling, general and administrative expenses for the six months ended June 30, 2013, increased by \$9,000 as compared with the same period in 2012. The primary factor of this decrease was a \$313,000 decrease in commissions due to decreased sales to Brazil along with decreases in consulting fees of \$63,000 and in bad debt allowance of \$33,000. The following expense categories experienced an increase of greater than \$30,000, which partially offset the decreases: wages and related expenses, travel, entertainment and trade shows, and other expenses which primarily include excise tax expense related to the health care act.

**Other Income and (Expense):**

	For the six months ended		\$ Change	% Change
	June 30, 2013	June 30, 2012		
Other income (expense)	\$ 7,500	\$ -	\$ 7,500	100.00%
Interest income	2,235	3,117	(882)	-28.30%
Interest expense	(335)	(4,758)	4,423	-92.96%
<b>Total Other Income and (Expense)</b>	<b>\$ 9,400</b>	<b>\$ (1,641)</b>	<b>\$ 11,041</b>	<b>-672.82%</b>

Other income for the six months ended June 30, 2013 increased approximately \$11,000, due to an income of \$9,000 from an expense of \$2,000 in the same period in 2012, primarily as a result of a gain on the sale of fixed assets and a decrease in interest expense due on the term loan with HSBC.

**Income tax (benefit) provision:**

For the six months ended June 30, 2013 the Company charged \$40,000 to income tax expense and reduced its deferred tax assets by \$36,000. The Company maintains a full valuation allowance on research and development tax credits.

## MATERIAL CHANGES IN FINANCIAL CONDITION

Selected Changes in Financial Condition	As of		\$ Change	% Change
	June 30, 2013	December 31, 2012		
Cash and cash equivalents	\$ 8,645,392	\$ 2,951,859	\$ 5,693,533	192.88%
Accounts receivable, net of allowance for doubtful accounts of \$24,000 and \$58,000 at June 30, 2013 and December 31, 2012, respectively	3,894,207	4,821,357	(927,150)	-19.23%
Inventories	3,848,295	2,488,071	1,360,224	54.67%
Fixed assets, net of accumulated depreciation	1,832,570	1,427,646	404,924	28.36%
Deposits on manufacturing equipment	1,975	223,584	(221,609)	-99.12%
Deferred tax asset, net of valuation allowance	4,197,113	4,233,194	(36,081)	-0.85%
Accounts payable and accrued liabilities	\$ 3,929,431	\$ 3,303,923	\$ 625,508	18.93%

Cash increased by \$5,694,000 from December 31, 2012, primarily due to the common stock funding completed in April 2013 which added \$5,409,000. Excluding the financing, the increase in cash was \$285,000. In addition there were decreases in accounts receivable, net of allowance, of \$927,000, deposits on manufacturing equipment of \$222,000 and deferred tax asset of \$36,000. We experienced increases in inventories of \$1,360,000, fixed assets of \$405,000 and accounts payable and accrued expenses of \$626,000.

The decrease in accounts receivable was primarily attributable to a larger amount of credit sales at the end of December of 2012 versus June of 2013. The increase in inventories is due to production for orders received to be shipped in the third quarter of 2013, which partially explains the increase in accounts payable and other accrued expenses. The increase in fixed assets is due in part to delivery of equipment for which we had made deposits, this equipment included vial filing equipment, a reel-to-reel printer for R&D, some leasehold improvements, and other pieces of equipment. Deferred tax asset decrease is related to the provision for income tax expense.

## LIQUIDITY AND CAPITAL RESOURCES

	For the six months ended		\$ Change	% Change
	June 30, 2013	June 30, 2012		
Net cash provided by operating activities	\$ 802,771	\$ 1,785,354	\$ (982,583)	-55.04%
Net cash used in investing activities	(415,649)	(447,621)	31,972	-7.14%
Net cash provided by financing activities	5,306,411	41,354	5,265,057	12731.68%
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>\$ 5,693,533</b>	<b>\$ 1,379,087</b>	<b>\$ 4,314,446</b>	<b>312.85%</b>

The Company's cash increased by \$5,694,000 from December 31, 2012, primarily due to the common stock funding completed in April 2013 which added \$5,409,000 and was partially offset by other uses of cash from financing activities, compared to an increase in cash of \$1,379,000 in the 2012 period.

The cash provided from operations in 2013 was \$803,000, primarily due to a reduction in accounts receivable of \$961,000 along with an increase of \$626,000 in accounts payable and other accrued liabilities and net income net of non-cash items of \$588,000 which were partially offset by an increase of \$1,360,000 in inventory. Net income net of non-cash items includes net income of \$76,000, \$282,000 in depreciation and amortization, \$222,000 in share-based compensation as well as other items aggregating \$19,000. The use of cash from investing activities is primarily the purchase of fixed assets.

The increase in cash from operations in 2012 was \$1,785,000, primarily due to net income net of non-cash items of \$1,631,000 a reduction in accounts receivable of \$783,000 along with an increase of \$416,000 in customer deposits, which were partially offset by a decrease of \$149,000 in accounts payable and accrued liabilities, an increase of \$841,000 in inventory and other items aggregating \$54,000. Net income net of non-cash items includes net income of \$742,000, \$270,000 in depreciation and amortization, \$179,000 in share-based compensation, \$440,000 in provision for deferred taxes. The use of cash from investing activities is primarily the purchase of fixed assets.

### Fixed Asset Commitments

As of June 30, 2013, the Company had paid deposits on various pieces of equipment aggregating \$1,975, which is reflected in deposits on manufacturing equipment on the balance sheet. The Company has no further commits for additional equipment purchase obligations.

The operating loss in the second quarter is because of a combination of increased operating expenses, especially an increase in clinical trial expenses attributable to our DPP® HIV 1/2 Assay CLIA waiver studies, and decreased product sales. Also, we made the decision to add significant manufacturing personnel in the second quarter in order to meet significantly larger unit volumes that were anticipated for the balance of this year. Although this level of cost would not be justified based on the second quarter revenues, it was critical in order to meet current demand; based on our current backlog and anticipated orders, these staffing increases were necessary. We anticipate completing shipment of the \$5.3MM order we received in June in the third quarter. Also, as reported, an increased level of sponsored research and development contracts with U.S. government agencies or their contractors, as compared with the second half of 2012, will subsidize our research and development activities, extend our development capabilities and know-how, potentially result in new product opportunities, and also have a positive impact on our operating results net of the costs incurred related to these projects.

We believe that there are a number of international procurement opportunities for our HIV, syphilis, and other products and we are vigorously pursuing such opportunities. It is difficult to predict whether or when we are going to be successful in these opportunities, and they typically result in significant variations to our quarterly results; however we believe we can continue to grow our international business with our high quality products.

Our ongoing efforts to improve our gross margins are beginning to yield results, as our production efficiencies have improved during the first half of 2013. This, combined with a very high equipment capacity utilization and an improved sales mix, should result in higher gross margins during the second half of 2013. These efforts, which began last year, have also been more recently impacted by organizational changes that included the appointment of Sharon Klugewicz as our Chief Operating Officer and related changes to our operating team. In addition to an increased focus on material usage, supply management, and automation, including reorganizing certain manufacturing support teams, the Company is implementing a short-term plan to expand its available production capacity by leasing adjacent space that can be used for new packaging and related equipment that has been ordered. This capacity is anticipated to be available for use before the end of 2013. Also we continue to explore various options relating to a longer-term facility expansion or relocation.

We have made good progress in our development programs, particularly in our CLIA waiver studies for our DPP® HIV 1/2 Assay and in our having established with the FDA the pathway to regulatory approval for our unique DPP® HIV-Syphilis assay.

On the DPP® HIV 1/2 Assay CLIA waiver study, we are now well on our way to completing the study. However enrollment is slower than planned which, when combined with startup delays will delay when we can file our CLIA waiver application until the fourth quarter. This means therefore that we would not reasonably expect to receive a CLIA waiver decision until early 2014. While disappointing, we believe this kind of delay is not unusual in these circumstances.

On the DPP® HIV-Syphilis product we have made excellent progress with this product in terms of international evaluations and registrations, and we believe that this will result in revenues in the near term. However, the FDA review timeline for this product, which we originally anticipated would be in mid-2014, has now been shifted to late 2014, with CLIA waiver now anticipated in early 2015. This development is due to this product being characterized by the FDA as a PMA, not a 510(K). This change will be more time consuming due to the increased statutory review time, and potentially more costly.

Although there are some challenges in public health budgets due to sequestration, our U.S. product revenues have remained strong. We are ever more optimistic that routine HIV testing will be expanded in the U.S. as a result of the recent full and final endorsement by the U.S. Preventive Services Task Force (USPSTF), with an "A" rating, of the CDC HIV testing recommendations. This is an important development as we near full implementation of the Affordable Care Act. Also, the USPSTF's recently issued final recommendation on HCV testing validates our HCV rapid test development program, which is proceeding for this product, as more efficacious therapies are expected to come to market, causing an anticipated scale-up in testing, both in the laboratory and at the point of care.

Our plans to directly market our DPP® HIV 1/2 Assay, and future FDA approved products, under Chembio brands, are also expected to enable us to enjoy increased gross margins, but there will be an offsetting cost of supporting this effort from establishing a direct sales and customer and distributor support team, which we are beginning now with some key hires. If we are able to achieve our plan to bring the additional products in our pipeline through this organization, these costs will be distributed over a larger revenue base. This strategy allows Chembio to build a brand in the United States.

We now also have the opportunity, if we choose to do so, to re-brand our FDA- approved lateral flow HIV rapid tests, which are currently sold by Alere under its Clearview brand, and sell them directly to the market or through distributors, under Chembio brands. This opportunity has come about due to Alere's decision, as anticipated, to introduce a competitive rapid HIV test in the United States, which decision triggered a provision in our agreements with Alere. That provision in our agreement gives Chembio the option, at any time, to terminate Alere's rights to market the cassette agreement and/or to make Alere non-exclusive on the barrel product, although the agreements terminate in 2016 in any case. We are in discussions with Alere concerning alternatives that we believe could be mutually beneficial.

Notwithstanding Alere's decision to compete, we believe that Alere has every interest in continuing to successfully market and promote our lateral flow products for so long as it is in their best interest to do so.

The Company has also been evaluating a number of new technologies that could be the basis for new products.

Our opportunities to sell our products under our own brand, expand and improve our facility, and identify new technologies all come at a time when we are looking forward to completing our fifth straight year of top line growth and profitability, with our strongest balance sheet position ever.

#### ITEM 4. CONTROLS AND PROCEDURES

- (a) **Disclosure Controls and Procedures.** Under the supervision and with the participation of our senior management, consisting of our chief executive officer and our chief financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this report (the "Evaluation Date"). Based on that evaluation, the Company's management, including our chief executive officer and chief financial officer, concluded that as of the Evaluation Date our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. Our disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our Exchange Act reports is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.
- (b) **Changes in Internal Control over Financial Reporting.** There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 under the Exchange Act that occurred during the Company's first six months of fiscal 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### PART II. OTHER INFORMATION

## EXHIBITS INDEX

Number	Description
3.1	Articles of Incorporation, as amended. (1)
3.2	Amended and Restated Bylaws. (2)
4.1*	Form of Employee Option Agreement. (3)
4.2	1999 Equity Incentive Plan. (4)
4.3	2008 Stock Incentive Plan. (5)
4.4	Rights Agreement, dated March 8, 2010 (6)
4.5	Form of Warrant (to be filed by amendment) [to be revised]
10.1*	Employment Agreement dated June 15, 2006 with Lawrence A. Siebert, as extended. (7)(11)
10.2*	Employment Agreement dated March 5, 2013 with Javan Esfandiari (10).
10.3*	Employment Agreement dated May 22, 2013 with Sharon Klugewicz
10.4	HIV Barrel License, Marketing and Distribution Agreement, dated as of September 29, 2006, by and among the Registrant, Alere and StatSure. (8)
10.5	HIV Cassette License, Marketing and Distribution Agreement, dated as of September 29, 2006, between the Registrant and Alere. (8)
10.6	Non-Exclusive License, Marketing and Distribution Agreement, dated as of September 29, 2006, between the Registrant and Alere. (8)
10.7	Joint HIV Barrel Product Commercialization Agreement, dated as of September 29, 2006, between the Registrant and StatSure. (8)
10.8	Secured Revolving Demand Note, dated as of April 30, 2013, by and among the Registrant, Chembio Diagnostics Systems, Inc. and HSBC Bank, NA
10.9	Loan and Security Agreement, dated as of April 30, 2013, by and among the Registrant, Chembio Diagnostics Systems, Inc. and HSBC Bank, NA
14.1	Ethics Policy (9)
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document
1	Incorporated by reference to the Registrant's annual report on Form 10-KSB filed with the Commission on March 31, 2005.
2	Incorporated by reference to the Registrant's registration statement on Form SB-2 (File No. 333-85787) filed with the Commission on August 23, 1999 and the Registrant's Forms 8-K filed on May 14, 2004, December 20, 2007 and April 18, 2008.
3	Incorporated by reference to the Registrant's annual report on Form 10-KSB filed with the Commission on March 12, 2008.
4	Incorporated by reference to the Registrant's definitive proxy statement on Schedule 14A filed with the Commission on May 11, 2005.
5	Incorporated by reference to the Registrant's definitive proxy statement on Schedule 14A filed with the Commission on April 14, 2008.
6	Incorporated by reference to the Registrant's registration statement on Form 8-A filed with the Commission on March 11, 2010.
7	Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Commission on June 21, 2006.
8	Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Commission on October 5, 2006.
9	Incorporated by reference to the Registrant's Annual Report on Form 10-KSB filed with the Commission on March 30, 2006.
10	Incorporated by reference to the Registrant's Annual Report on Form 10-K filed with the Commission on March 7, 2013.
11	Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Commission on April 25, 2013.
(*)	An asterisk (*) beside an exhibit number indicates the exhibit contains a management contract, compensatory plan or arrangement which is required to be identified in this report.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Chembio Diagnostics, Inc.

Date: August 8, 2013 By: /s/ Lawrence A. Siebert  
Lawrence A. Siebert  
Chief Executive Officer  
(Principal Executive Officer)

Date: August 8, 2013 By: /s / Richard J. Larkin  
Richard J. Larkin  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

## REVOLVING DEMAND NOTE

April 30, 2013

**\$2,000,000.00**

For value received, the undersigned **Chembio Diagnostic Systems, Inc., a Delaware corporation**, with an address of **3661 Horseblock Road, Medford, New York 11763** (the "Borrower"), promises to pay to the order of HSBC Bank USA, National Association, a bank organized under the laws of the United States of America with an address of One HSBC Center, 8th Floor, Buffalo, New York 14203 (together with its successors and assigns, the "Bank"), **ON DEMAND**, the principal amount of **Two Million Dollars and Zero Cents (\$2,000,000.00)** or, if less, such amount as may be the aggregate unpaid principal amount of all loans or advances made by the Bank to the Borrower pursuant hereto, together with interest from the date hereof on the unpaid principal balance from time to time outstanding until paid in full. The aggregate principal balance outstanding shall bear interest thereon at a per annum rate equal to **One-Quarter Percent (.25%)** above the Prime Rate (as hereinafter defined). All accrued and unpaid interest shall be payable monthly in arrears on the same day of the month as the date of this Note or if such day does not exist on the last day of each such month, commencing on the day which is one month from the date of this Note or if such day does not exist on the last day of such month.

Prime Rate means the rate per annum from time to time established by the Bank as the Prime Rate and made available by the Bank at its main office or, in the discretion of the Bank, the base, reference or other rate then designated by the Bank for general commercial loan reference purposes, it being understood that such rate is a reference rate, not necessarily the lowest, established from time to time, which serves as the basis upon which effective interest rates are calculated for loans making reference thereto.

The effective interest rate applicable to the Borrower's loans evidenced hereby shall change on the date of each change in the Prime Rate.

Notwithstanding anything to the contrary in this Note, the outstanding principal balance shall bear interest at the rate otherwise set forth in this Note plus an additional One-Quarter Percent (0.25%) per annum in the event the undersigned does not maintain a demand deposit account with the HSBC Bank USA, National Association from which the amounts due under this Note are automatically deducted.

Principal and interest shall be payable at the Bank's main office or at such other place as the Bank may designate in writing in immediately available funds in lawful money of the United States of America without set-off, deduction or counterclaim. Interest shall be calculated monthly on the basis of a 360-day year based on twelve (12) thirty (30) day months except that interest due and payable for a period of less than a full month shall be calculated by multiplying the actual number of days elapsed in such period by a daily rate based on said 360-day year.

This Note is a revolving note and, subject to the foregoing and in accordance with the provisions hereof and of any and all other agreements between the Borrower and the Bank related hereto, the Borrower may, at its option, borrow, pay, prepay and reborrow hereunder at any time prior to demand for payment hereunder or such earlier date as the obligations of the Borrower to the Bank under this Note, and any other agreements between the Bank and the Borrower related hereto, shall become due and payable; provided, however, that in any event the principal balance outstanding hereunder shall at no time exceed the face amount of this Note. This Note shall continue in full force and effect until all obligations and liabilities evidenced by this Note are paid in full, even if, from time to time, there are no amounts outstanding respecting this Note. Notwithstanding that this Note shall be due and payable **ON DEMAND**, the Bank's agreement to advance funds respecting this Note shall be subject to annual review; and there shall be no further advances respecting this Note unless the Bank, in its sole discretion, determines that it shall continue to make advances after any such annual review; provided, that notwithstanding such annual review as provided in this paragraph, this Note shall be due and payable **ON DEMAND**. Nothing contained in this Note or otherwise is intended, nor shall constitute, an obligation of the Bank to make any loan or advance.

Any payments received by the Bank on account of this Note shall, at the Bank's option, be applied first, to accrued and unpaid interest and/or annual fees; second, to the unpaid principal balance hereof; third to any costs, expenses or charges then owed to the Bank by the Borrower; and the balance to escrows, if any. Notwithstanding the foregoing, any payments received after demand for payment shall be applied in such manner as the Bank may determine. The Borrower hereby authorizes the Bank to charge any deposit account which the Borrower may maintain with the Bank for any payment required hereunder without prior notice to the Borrower.

If pursuant to the terms of this Note, the Borrower is at any time obligated to pay interest on the principal balance at a rate in excess of the maximum interest rate permitted by applicable law for the loan evidenced by this Note, the applicable interest rate shall be immediately reduced to such maximum rate and all previous payments in excess of the maximum rate shall be deemed to have been payments in reduction of principal and not on account of the interest due hereunder.

**The Borrower represents to the Bank that the proceeds of this Note will not be used for personal, family or household purposes or for the purpose of purchasing or carrying margin stock or margin securities within the meaning of Regulations U and X of the Board of Governors of the Federal Reserve System, 12 C.F.R. Parts 221 and 224.**

The Borrower and each endorser and guarantor hereof grant to the Bank a continuing lien on and security interest in any and all deposits or other sums at any time credited by or due from the Bank or any Bank Affiliate (as hereinafter defined) to the Borrower and/or each endorser or guarantor hereof and any cash, securities, instruments or other property of the Borrower and each endorser and guarantor hereof in the possession of the Bank or any Bank Affiliate, whether for safekeeping or otherwise, or in transit to or from the Bank or any Bank Affiliate (regardless of the reason the Bank or Bank Affiliate had received the same or whether the Bank or Bank Affiliate has conditionally released the same) as security for the full and punctual payment and performance of all of the liabilities and obligations of the Borrower and/or any endorser or guarantor hereof to the Bank or any Bank Affiliate and such deposits and other sums may be applied or set off against such liabilities and obligations of the Borrower or any endorser or guarantor hereof to the Bank or any Bank Affiliate at any time.

No delay or omission on the part of the Bank in exercising any right hereunder shall operate as a waiver of such right or of any other right of the Bank, nor shall any delay, omission or waiver on any one occasion be deemed a bar to or waiver of the same or any other right on any future occasion. The Borrower and every endorser or guarantor of this Note, regardless of the time, order or place of signing, waive presentment, demand, protest, notice of intent to accelerate, notice of acceleration and all other notices of every kind in connection with the delivery, acceptance, performance or enforcement of this Note and assent to any extension or postponement of the time of payment or any other indulgence, to any substitution, exchange or release of collateral, and to the addition or release of any other party or person primarily or secondarily liable and waives all recourse to suretyship and guarantor defenses generally, including any defense based on impairment of collateral. To the maximum extent permitted by law, the Borrower and each endorser and guarantor of this Note waive and terminate any homestead rights and/or exemptions respecting any premises under the provisions of any applicable homestead laws, including without limitation, Section 5206 of the Civil Practice Law and Rules of New York.

The Borrower and each endorser and guarantor of this Note shall indemnify, defend and hold the Bank and the Bank Affiliates and their directors, officers, employees, agents and attorneys (each an "Indemnitee") harmless against any claim brought or threatened against any Indemnitee by the Borrower, by any endorser or guarantor, or by any other person (as well as from attorneys' reasonable fees and expenses in connection therewith) on account of the Bank's relationship with the Borrower or any endorser or guarantor hereof (each of which may be defended, compromised, settled or pursued by the Bank with counsel of the Bank's selection, but at the expense of the Borrower and any endorser and/or guarantor), except for any claim arising out of the gross negligence or willful misconduct of the Bank.

The Borrower and each endorser and guarantor of this Note agree to pay, upon demand, costs of collection of all amounts under this Note including, without limitation, principal and interest, or in connection with the enforcement of, or realization on, any security for this Note, including, without limitation, to the extent permitted by applicable law, reasonable attorneys' fees and expenses. Upon demand for payment of any amounts hereunder, and, at the election of the Bank, upon the occurrence of an Event of Default under Borrower's Loan and Security Agreement with the Bank, interest shall accrue at a rate per annum equal to the aggregate of 3.0% plus the rate provided for herein. If any payment due under this Note is unpaid for 10 days or more, the Borrower shall pay, in addition to any other sums due under this Note (and without limiting the Bank's other remedies on account thereof), a late charge equal to the greater of \$15 or 5.0% of such unpaid amount (which amount shall be subject to and limited so as to not be in violation of the provisions of Section 254-b of New York Real Property Law, if applicable).

This Note shall be binding upon the Borrower and each endorser and guarantor hereof and upon their respective heirs, successors, assigns and legal representatives, and shall inure to the benefit of the Bank and its successors, endorsees and assigns.

The liabilities of the Borrower and each Borrower, if more than one, and any endorser or guarantor of this Note are joint and several; provided, however, the release by the Bank of the Borrower or any one or more endorsers or guarantors shall not release any other person obligated on account of this Note. Any and all present and future debts of the Borrower to any endorser or guarantor of this Note are subordinated to the full payment and performance of all present and future debts and obligations of the Borrower to the Bank. Each reference in this Note to the Borrower and each Borrower, if more than one, and endorser or guarantor of this Note, is to such person individually and also to all such persons jointly. No person obligated on account of this Note may seek contribution from any other person also obligated, unless and until all liabilities, obligations and indebtedness to the Bank of the person from whom contribution is sought have been irrevocably satisfied in full. The release or compromise by the Bank of any collateral shall not release any person obligated on account of this Note.

The Borrower and each endorser and guarantor hereof each authorizes the Bank to complete this Note if delivered incomplete in any respect. A photographic or other reproduction of this Note may be made by the Bank, and any such reproduction shall be admissible in evidence with the same effect as the original itself in any judicial or administrative proceeding, whether or not the original is in existence.

The Borrower will from time to time execute and deliver to the Bank such documents, and take or cause to be taken, all such other further action, as the Bank may request in order to effect and confirm or vest more securely in the Bank all rights contemplated by this Note or any other loan documents related thereto (including, without limitation, to correct clerical errors) or to vest more fully in or assure to the Bank the security interest in any collateral securing this Note or to comply with applicable statute or law.

This Note shall be governed by the laws of the State of New York without giving effect to the conflicts of laws principles thereof.

Any notices under or pursuant to this Note shall be deemed duly received and effective if delivered in hand to any officer or agent of the Borrower or Bank, or if mailed by registered or certified mail, return receipt requested, addressed to the Borrower or Bank at the address set forth in this Note or as any party may from time to time designate by written notice to the other party.

The term "Bank Affiliate" as used in this Note shall mean any "Affiliate" of the Bank or any lender acting as a participant under any loan arrangement between the Bank and the Borrower(s). The term "Affiliate" shall mean with respect to any person, (a) any person which, directly or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, such person, or (b) any person who is a director or officer (i) of such person, (ii) of any subsidiary of such person, or (iii) any person described in clause (a) above. For purposes of this definition, control of a person shall mean the power, direct or indirect, (x) to vote 5% or more of the Capital Stock having ordinary voting power for the election of directors (or comparable equivalent) of such person, or (y) to direct or cause the direction of the management and policies of such person whether by contract or otherwise. Control may be by ownership, contract, or otherwise.

No change in any provision of this Note may be made except by a writing signed by authorized signers of both parties to this Note, except that the Bank is authorized to fill in any blank spaces and to otherwise complete this Note and correct any patent errors herein.

All of the Bank's rights and remedies not only under the provisions of this Note but also under any other agreement or transaction shall be cumulative and not alternative or exclusive, and may be exercised by the Bank at such time or times and in such order of preference as the Bank in its sole discretion may determine.

The Borrower and each endorser and guarantor of this Note each irrevocably submits to the nonexclusive jurisdiction of any Federal or state court sitting in New York, over any suit, action or proceeding arising out of or relating to this Note. Each of the Borrower and each endorser and guarantor irrevocably waives, to the fullest extent it may effectively do so under applicable law, any objection it may now or hereafter have to the laying of the venue of any such suit, action or proceeding brought in any such court and any claim that the same has been brought in an inconvenient forum. Each of the Borrower and each endorser and guarantor hereby consents to any and all process which may be served in any such suit, action or proceeding, (i) by mailing a copy thereof by registered and certified mail, postage prepaid, return receipt requested, to the Borrower's, endorser's or guarantor's address shown below or as notified to the Bank and (ii) by serving the same upon the Borrower(s), endorser(s) or guarantor(s) in any other manner otherwise permitted by law, and agrees that such service shall in every respect be deemed effective service upon the Borrower or such endorser or guarantor.

**THE BORROWER AND EACH ENDORSER AND GUARANTOR ACKNOWLEDGE THAT THIS NOTE IS A DEMAND NOTE AND THE RIGHT OF THE BANK TO DEMAND PAYMENT OF THIS NOTE IN WHOLE OR IN PART AT ANY TIME SHALL BE ABSOLUTE, UNCONDITIONAL AND IN THE SOLE DISCRETION OF THE BANK. THE INCLUSION OF EVENTS OF DEFAULT AND COVENANTS IN ANY LOAN DOCUMENTS BETWEEN THE BANK AND THE BORROWER OR ANY ENDORSER OR GUARANTOR OR ANY OTHER PARTY DELIVERED IN CONNECTION WITH THIS NOTE OR OTHERWISE SHALL NOT IN ANY WAY LIMIT THE DEMAND NATURE OF THIS NOTE AND THE BANK MAY MAKE DEMAND FOR PAYMENT AT ANY TIME FOR ANY OR NO REASON, WHETHER OR NOT AN EVENT OF DEFAULT HAS OCCURRED UNDER ANY SUCH LOAN DOCUMENTS.**

**THE BORROWER, EACH ENDORSER AND GUARANTOR AND THE BANK EACH HEREBY KNOWINGLY, VOLUNTARILY AND INTENTIONALLY, AND AFTER AN OPPORTUNITY TO CONSULT WITH LEGAL COUNSEL, (A) WAIVES ANY AND ALL RIGHTS TO A TRIAL BY JURY IN ANY ACTION OR PROCEEDING IN CONNECTION WITH THIS NOTE, ANY OF THE OBLIGATIONS OF THE BORROWER, EACH ENDORSER AND GUARANTOR TO THE BANK, AND ALL MATTERS CONTEMPLATED HEREBY AND DOCUMENTS EXECUTED IN CONNECTION HERewith AND (B) AGREES NOT TO SEEK TO CONSOLIDATE ANY SUCH ACTION WITH ANY OTHER ACTION IN WHICH A JURY TRIAL CAN NOT BE, OR HAS NOT BEEN, WAIVED. THE BORROWER, EACH ENDORSER AND GUARANTOR AND THE BANK EACH CERTIFIES THAT NEITHER THE BANK NOR ANY OF ITS REPRESENTATIVES, AGENTS OR COUNSEL HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT THE BANK WOULD NOT IN THE EVENT OF ANY SUCH PROCEEDING SEEK TO ENFORCE THIS WAIVER OF RIGHT TO TRIAL BY JURY.**

Executed as of \_\_\_\_\_, 2013.

Signature Verified:

Borrower:

Chembio Diagnostic Systems, Inc.

\_\_\_\_\_

By: \_\_\_\_\_

Name:

Title:

\_\_\_\_\_

By: \_\_\_\_\_

Name:

Title:

3661 Horseblock Road  
Medford, New York  
11763

Promissory Notes 2013 Medici, a division of Wolters Kluwer Financial Services

HSBC (LOGO)

**LOAN AND SECURITY AGREEMENT**

This LOAN AND SECURITY AGREEMENT (this "Agreement") is entered into as of **April 30, 2013**, between **Chembio Diagnostic Systems, Inc., a Delaware corporation**, with its chief executive office located at **3661 Horseblock Road, Medford, New York 11763** (the "Borrower") and HSBC Bank USA, National Association, a bank organized under the laws of the United States of America, with an address of One HSBC Center, 8th Floor, Buffalo, New York 14203 (the "Bank").

FOR VALUE RECEIVED, and in consideration of the granting by the Bank of financial accommodations to or for the benefit of the Borrower, including without limitation respecting the Obligations (as hereinafter defined), the Borrower represents to and agrees with the Bank, as of the date hereof and as of the date of each loan, credit and/or other financial accommodation, as follows:

**1. THE LOAN**

**1.1 Loan(s).** Bank agrees, from time to time, in its sole discretion, to make loans (collectively, the "Loans") to or for the account of Borrower, upon Borrower's request therefor, in such amounts as shall be mutually agreed upon, subject to the terms and conditions set forth herein.

Loans shall be evidenced by one or more notes issued by the Borrower in favor of the Bank (collectively, and each a "Note"). This Agreement, each Note any security agreements or guaranties and any and all other documents, amendments or renewals executed and delivered to the Bank are collectively hereinafter referred to as the "Loan Documents".

**1.2 Revolving Loans.** Bank agrees, in its sole discretion, to make revolving loans (the "Revolving Loans") to or for the account of Borrower, upon Borrower's request therefor, in such amounts as may from time to time be established by Bank, provided there is no continuing uncured Event of Default (as hereinafter defined) and subject to the terms and conditions set forth herein.

**1.3 Revolving Loan Account.** An account shall be opened on the books of Bank in which account a record will be kept of all Revolving Loans, and all payments thereon and other appropriate debits and credits as provided by this Agreement. No failure by the Bank to make and no error by the Bank in making, any entry in such books will affect the Borrower's obligation to repay the full principal amount advanced by the Bank to or for the account of the Borrower, or the Borrower's obligation to pay interest thereon at the agreed upon rate.

**1.4 Interest.** Interest respecting the Revolving Loans will be charged to Borrower on the principal amount from time to time outstanding at the interest rate specified in the Revolving Note in accordance with the terms of the Revolving Note.

**1.5 Demand and Annual Review.** All loans and advances made respecting the Revolving Loans shall be payable to Bank on DEMAND, notwithstanding the inclusion of events of default in this Agreement or in any other Loan Document and whether or not any event of default has occurred under this Agreement or any of the Loan Documents. Notwithstanding that all loans and advances made by Bank to Borrower under or pursuant to this Agreement respecting the Revolving Loans shall be due and payable ON DEMAND, the Bank's agreement to advance funds respecting the Revolving Loans shall be subject to annual review; and there shall be no further advances respecting the Revolving Loans unless the Bank, in its sole discretion, determines that it shall continue to make advances after any such annual review; provided, that notwithstanding such annual review as provided in this paragraph, all loans and advances made shall be due and payable ON DEMAND.

**1.6 Clean-Up.** The Borrower shall fully repay to the Bank all amounts outstanding respecting the Revolving Loans for a period of **30** consecutive days in each year.

**1.7 Overadvances.** Any Revolving Loans that may be made, at the Bank's sole discretion, in excess of the Revolving Loan Amount shall not limit the obligations of Borrower or any of the Bank's rights or remedies hereunder or under the Loan Documents or otherwise; all such Revolving Loans shall be secured by the Collateral, as hereinafter defined, and shall be due and payable to the Bank in accordance with the terms of the Revolving Note, and shall bear interest at the rate set forth in the Revolving Note. All checks or other items paid by Bank which cause an overdraft in any deposit account maintained by Borrower with Bank shall, at the option of the Bank, constitute an advance to Borrower pursuant to this Agreement respecting the Revolving Loans, repayable on demand, and shall be secured by all Collateral.

**1.8 Authorized Persons; Advances.** Any person duly authorized by a general borrowing resolution of the Borrower, or in the absence of such a resolution, the President, Treasurer or any Vice President of the Borrower, or any person otherwise authorized in this paragraph, may request discretionary loans hereunder, either orally or otherwise, but the Bank at its option may require that all requests for loans hereunder shall be in writing. The Bank shall incur no liability to Borrower in acting upon any request referred to herein which the Bank believes in good faith to have been made by an authorized person or persons. Each loan hereunder may be credited by Bank to any deposit account of Borrower with Bank or with any other Bank with which Borrower maintains a deposit account, or may be paid to Borrower (or as Borrower instructs) or may be applied to any Obligations, as Bank may in each instance elect.

**1.9 Monthly Statement.** At the option of the Bank, after the end of each month, Bank will render to Borrower a statement of the Revolving Loan account, showing all applicable credits and debits. Each statement shall be considered correct and to have been accepted by Borrower and shall be conclusively binding upon Borrower in respect of all charges, debits and credits of whatsoever nature contained therein respecting the Revolving Loans, and the closing balance shown therein, unless Borrower notifies Bank in writing of any discrepancy within Thirty (30) days from the mailing by Bank to Borrower of any such monthly statement.

**2. GRANT OF SECURITY INTEREST**

**2.1 Grant of Security Interest.** In consideration of the Bank's extending credit and other financial accommodations to or for the benefit of the Borrower, the Borrower hereby grants to the Bank a security interest in, a lien on and pledge and assignment of the Collateral (as hereinafter defined). The security interest granted by this Agreement is given to and shall be held by the Bank as security for the payment and performance of all Obligations, including, without limitation, all amounts outstanding pursuant to the Loan Documents.

**2.2 Definitions.** The following definitions shall apply:

- (a) "Bank Affiliate" shall mean any "Affiliate" of the Bank or any lender acting as a participant under any loan arrangement between the Bank and the Borrower(s). The term "Affiliate" shall mean with respect to any person, (a) any person which, directly or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, such person, or (b) any person who is a director or officer (i) of such person, (ii) of any subsidiary of such person, or (iii) any person described in clause (a) above. For purposes of this definition, control of a person shall mean the power, direct or indirect, (x) to vote 5% or more of the Capital Stock having ordinary voting power for the election of directors (or comparable equivalent) of such person, or (y) to direct or cause the direction of the management and policies of such person whether by contract or otherwise. Control may be by ownership, contract, or otherwise.
- (b) "Code" shall mean the New York Uniform Commercial Code as amended from time to time.
- (c) "Collateral" shall mean all of the Borrower's present and future right, title and interest in and to any and all of the following personal property of the Borrower whether such property is now existing or hereafter created, acquired or arising and wherever located from time to time, including without limitation:

- (i) accounts;
  - (ii) chattel paper;
  - (iii) goods;
  - (iv) inventory;
  - (v) equipment;
  - (vi) farm products;
  - (vii) instruments;
  - (viii) investment property;
  - (ix) documents;
  - (x) commercial tort claims;
  - (xi) deposit accounts;
  - (xii) letter-of-credit rights;
  - (xiii) general intangibles;
  - (xiv) supporting obligations;
  - (xv) All proceeds of collateral of every kind and nature in whatever form, including, without limitation, both cash and noncash proceeds resulting or arising from the sale or other disposition by the Borrower of the collateral; and
  - (xvi) All records and products of and accessions to any of the collateral.
- (d) "Debtors" shall mean the Borrower's customers who are indebted to the Borrower.
- (e) "Obligation(s)" shall mean, without limitation, all loans, advances, indebtedness, notes, liabilities, rate swap transactions, basis swaps, forward rate transactions, commodity swaps, commodity options, equity or equity index swaps, equity or equity index options, bond options, interest rate options, foreign exchange transactions, cap transactions, floor transactions, collar transactions, forward transactions, currency swap transactions, cross-currency rate swap transactions, currency options and amounts, liquidated or unliquidated, owing by the Borrower to the Bank or any Bank Affiliate at any time, of each and every kind, nature and description, whether arising under this Agreement or otherwise, and whether secured or unsecured, direct or indirect (that is, whether the same are due directly by the Borrower to the Bank or any Bank Affiliate; or are due indirectly by the Borrower to the Bank or any Bank Affiliate as endorser, guarantor or other surety, or as borrower of obligations due third persons which have been endorsed or assigned to the Bank or any Bank Affiliate, or otherwise), absolute or contingent, due or to become due, now existing or hereafter arising or contracted, including, without limitation, payment when due of all amounts outstanding respecting any of the Loan Documents. Said term shall also include all interest and other charges chargeable to the Borrower or due from the Borrower to the Bank or any Bank Affiliate from time to time and all costs and expenses referred to in this Agreement.
- (f) "Person" or "party" shall mean individuals, partnerships, corporations, limited liability companies and all other entities.

All words and terms used in this Agreement other than those specifically defined herein shall have the meanings accorded to them in the Code.

2.3 Ordinary Course of Business. The Bank hereby authorizes and permits the Borrower to hold, process, sell, use or consume in the manufacture or processing of finished goods, or otherwise dispose of inventory for fair consideration, all in the ordinary course of the Borrower's business, excluding, without limitation, sales to creditors or in bulk or sales or other dispositions occurring under circumstances which would or could create any lien or interest adverse to the Bank's security interest or other right hereunder in the proceeds resulting therefrom. The Bank also hereby authorizes and permits the Borrower to receive from the Debtors all amounts due as proceeds of the Collateral at the Borrower's own cost and expense, and also liability, if any, subject to the direction and control of the Bank at all times; and the Bank may at any time, notice, and whether or not an Event of Default has occurred or demand has been made, terminate all or any part of the authority and permission herein or elsewhere in this Agreement granted to the Borrower with reference to the Collateral, and notify Debtors to make all payments due as proceeds of the Collateral to the Bank. Until Bank shall otherwise notify Borrower, all proceeds of and collections of Collateral shall be retained by Borrower and used solely for the ordinary and usual operation of Borrower's business. From and after notice by Bank to Borrower, all proceeds of and collections of the Collateral shall be held in trust by Borrower for Bank and shall not be commingled with Borrower's other funds or deposited in any Bank account of Borrower; and Borrower agrees to deliver to Bank on the dates of receipt thereof by Borrower, duly endorsed to Bank or to bearer, or assigned to Bank, as may be appropriate, all proceeds of the Collateral in the identical form received by Borrower.

2.4 Allowances. Absent an Event of Default the Borrower may grant such allowances or other adjustments to Debtors (exclusive of extending the time for payment of any item which shall not be done without first obtaining the Bank's written consent in each instance) as the Borrower may reasonably deem to accord with sound business practice, including, without limiting the generality of the foregoing, accepting the return of all or any part of the inventory (subject to the provisions set forth in this Agreement with reference to returned inventory).

2.5 Records. The Borrower shall hold its books and records relating to the Collateral segregated from all the Borrower's other books and records in a manner satisfactory to the Bank; and shall deliver to the Bank from time to time promptly at its request all invoices, original documents of title, contracts, chattel paper, instruments and any other writings relating thereto, and other evidence of performance of contracts, or evidence of shipment or delivery of the merchandise or of the rendering of services; and the Borrower will deliver to the Bank promptly at the Bank's request from time to time additional copies of any or all of such papers or writings, and such other information with respect to any of the Collateral and such schedules of inventory, schedules of accounts and such other writings as the Bank may in its sole discretion deem to be necessary or effectual to evidence any loan hereunder or the Bank's security interest in the Collateral.

2.6 Legends. The Borrower shall promptly make, stamp or record such entries or legends on the Borrower's books and records or on any of the Collateral (including, without limitation, chattel paper) as Bank shall request from time to time, to indicate and disclose that Bank has a security interest in such Collateral.

2.7 Inspection. The Bank, or its representatives, at any time and from time to time, shall have the right at the sole cost and expense of Borrower, and the Borrower will permit the Bank and/or its representatives: (a) to examine, check, make copies of or extracts from any of the Borrower's books, records and files (including, without limitation, orders and original correspondence); (b) to perform field exams or otherwise inspect and examine the Collateral and to check, test or appraise the same as to quality, quantity, value and condition; and (c) to verify the Collateral or any portion or portions thereof or the Borrower's compliance with the provisions of this Agreement.

2.8 Purchase Money Security Interests. To the extent the Borrower uses proceeds of any loans to purchase Collateral, the repayment of such loans shall be on a "first-in-first-out" basis so that the portion of the loan used to purchase a particular item of Collateral shall be repaid in the order in which Borrower purchased such item of Collateral.

2.9 Search Reports. Bank shall receive prior to the date of this Agreement UCC search results under all names used by the Borrower during the prior five (5) years, from each jurisdiction where any Collateral is located, from the State, if any, where the Borrower is organized and registered (as such terms are used in the Code), and the State where the Borrower's chief executive office is located. The search results shall confirm that the security interest in the Collateral granted Bank hereunder is prior to all other security interests in favor of any other person.

### 3. REPRESENTATIONS AND WARRANTIES

3.1 Organization and Qualification. Borrower is a duly organized and validly existing corporation under the laws of the State of its incorporation with the exact legal name set forth in the first paragraph of this Agreement. Borrower is in good standing under the laws of said State, has the power to own its property and conduct its business as now conducted and as currently proposed to be conducted, and is duly qualified to do business under the laws of each state where the nature of the business done or property owned requires such qualification.

3.2 Subsidiaries. Borrower has no subsidiaries other than as previously specifically consented to in writing by the Bank, if any, and the Borrower has never consolidated, merged or acquired substantially all of the assets of any other entity or person other than as previously specifically consented to in writing by the Bank, if any.

3.3 Corporate Records. Borrower's corporate charter, articles or certificate of organization or incorporation and all amendments thereto have been duly filed and are in proper order. All outstanding capital stock issued by the Borrower was and is properly issued and all books and records of the Borrower, including but not limited to its minute books, bylaws and books of account, are accurate and up to date and will be so maintained.

3.4 Title to Properties; Absence of Liens. Borrower has good and clear record and marketable title to all of its properties and assets, and all of its properties and assets including the Collateral are free and clear of all mortgages, liens, pledges, charges, encumbrances and setoffs, other than the security interest therein granted to the Bank and those mortgages, deeds of trust, leases of personal property and security interests previously specifically consented to in writing by the Bank.

3.5 Places of Business. Borrower's chief executive office is correctly stated in the preamble to this Agreement, and Borrower shall, during the term of this Agreement, keep the Bank currently and accurately informed in writing of each of its other places of business, and shall not change the location of such chief executive office or open or close, move or change any existing or new place of business without giving the Bank at least thirty (30) days prior written notice thereof.

3.6 Valid Obligations. The execution, delivery and performance of the Loan Documents have been duly authorized by all necessary corporate action and each represents a legal, valid and binding obligation of Borrower and is fully enforceable according to its terms, except as limited by laws relating to the enforcement of creditors' rights.

3.7 Conflicts. There is no provision in Borrower's organizational or charter documents, if any, or in any indenture, contract or agreement to which Borrower is a party which prohibits, limits or restricts the execution, delivery or performance of the Loan Documents.

3.8 Governmental Approvals. The execution, delivery and performance of the Loan Documents does not require any approval of or filing with any governmental agency or authority.

3.9 Litigation, etc. There are no actions, claims or proceedings pending or to the knowledge of Borrower threatened against Borrower which might materially adversely affect the ability of Borrower to conduct its business or to pay or perform the Obligations.

3.10 Accounts and Contract Rights. All accounts arise out of legally enforceable and existing contracts, and represent unconditional and undisputed bona fide indebtedness by a Debtor, and are not and will not be subject to any discount (except such cash or trade discount as may be shown on any invoice, contract or other writing delivered to the Bank). No contract right, account, general intangible or chattel paper is or will be represented by any note or other instrument, and no contract right, account or general intangible is, or will be represented by any conditional or installment sales obligation or other chattel paper, except such instruments or chattel paper as have been or immediately upon receipt by the Borrower will be delivered to the Bank (duly endorsed or assigned), such delivery, in the case of chattel paper, to include all executed copies except those in the possession of the installment buyer and any security for or guaranty of any of the Collateral shall be delivered to the Bank immediately upon receipt thereof by the Borrower, with such assignments and endorsements thereof as the Bank may request.

3.11 Title to Collateral. At the date hereof the Borrower is (and as to Collateral that the Borrower may acquire after the date hereof, will be) the lawful owner of the Collateral, and the Collateral and each item thereof is, will be and shall continue to be free of all restrictions, liens, encumbrances or other rights, title or interests (other than the security interest therein granted to the Bank), credits, defenses, recoupments, set-offs or counterclaims whatsoever. The Borrower has and will have full power and authority to grant to the Bank a security interest in the Collateral and the Borrower has not transferred, assigned, sold, pledged, encumbered, subjected to lien or granted any security interest in, and will not transfer, assign, sell (except sales or other dispositions in the ordinary course of business in respect to inventory as expressly permitted in this Agreement), pledge, encumber, subject to lien or grant any security interest in any of the Collateral (or any of the Borrower's right, title or interest therein), to any person other than the Bank. The Collateral is and will be valid and genuine in all respects. The Borrower will warrant and defend the Bank's right to and interest in the Collateral against all claims and demands of all persons whatsoever.

3.12 Location of Collateral. Except for sale, processing, use, consumption or other disposition in the ordinary course of business, the Borrower will keep all inventory and equipment only at locations specified in this Agreement or specified to the Bank in writing. The Borrower shall, during the term of this Agreement, keep the Bank currently and accurately informed in writing of each location where the Borrower's records relating to its accounts and contract rights, respectively, are kept, and shall not remove such records or any of them to another location without giving the Bank at least thirty (30) days prior written notice thereof.

3.13 Third Parties. The Bank shall not be deemed to have assumed any liability or responsibility to the Borrower or any third person for the correctness, validity or genuineness of any instruments or documents that may be released or endorsed to the Borrower by the Bank (which shall automatically be deemed to be without recourse to the Bank in any event) or for the existence, character, quantity, quality, condition, value or delivery of any goods purporting to be represented by any such documents; and the Bank, by accepting such security interest in the Collateral, or by releasing any Collateral to the Borrower, shall not be deemed to have assumed any obligation or liability to any supplier or

Debtor or to any other third party, and the Borrower agrees to indemnify and defend the Bank and hold it harmless in respect to any claim or proceeding arising out of any matter referred to in this paragraph.

**3.14 Payment of Accounts.** Each account or other item of Collateral, other than inventory and equipment, will be paid in full within 30 days the date shown as its due date in the schedule of Collateral, in the copy of the invoice(s) relating to the account or other Collateral or in contracts relating thereto. Upon any suspension of business, assignment or trust mortgage for the benefit of creditors, dissolution, petition in receivership or under any chapter of the Bankruptcy Code as amended from time to time by or against any Debtor, any Debtor becoming insolvent or unable to pay its debts as they mature or any other act of the same or different nature amounting to a business failure, the Borrower will immediately notify the Bank thereof.

**3.15 Taxes.** The Borrower has filed all Federal, state and other tax returns required to be filed (except for such returns for which current and valid extensions have been filed), and all taxes, assessments and other governmental charges due from the Borrower have been fully paid. The Borrower has established on its books reserves adequate for the payment of all Federal, state and other tax liabilities (if any).

**3.16 Use of Proceeds.** No portion of any loan is to be used for (i) the purpose of purchasing or carrying any "margin security" or "margin stock" as such terms are used in Regulations U and X of the Board of Governors of the Federal Reserve System, 12 C.F.R. 221 and 224 or (ii) primarily personal, family or household purposes. The Collateral is not used or acquired primarily for personal, family or household purposes.

**3.17 Environmental.** As of the date hereof neither the Borrower nor any of Borrower's agents, employees or independent contractors (1) have caused or are aware of a release or threat of release of Hazardous Materials (as defined herein) on any of the premises or personal property owned or controlled by Borrower ("Controlled Property") or any property abutting Controlled Property ("Abutting Property"), which could give rise to liability under any Environmental Law (as defined herein) or any other Federal, state or local law, rule or regulation; (2) have arranged for the transport of or transported any Hazardous Materials in a manner as to violate, or result in potential liabilities under, any Environmental Law; (3) have received any notice, order or demand from the Environmental Protection Agency or any other Federal, state or local agency under any Environmental Law; (4) have incurred any liability under any Environmental Law in connection with the mismanagement, improper disposal or release of Hazardous Materials; or (5) are aware of any inspection or investigation of any Controlled Property or Abutting Property by any Federal, state or local agency for possible violations of any Environmental Law.

To the best of Borrower's knowledge, neither Borrower, nor any prior owner, operator or tenant of any Controlled Property, committed or omitted any act which caused the release of Hazardous Materials on such Controlled Property which could give rise to a lien thereon by any Federal, state or local government. No notice or statement of claim or lien affecting any Controlled Property has been recorded or filed in any public records by any Federal, state or local government for costs, penalties, fines or other charges as to such property. All notices, permits, licenses or similar authorizations, if any, required to be obtained or filed in connection with the ownership, operation, or use of the Controlled Property, including without limitation, the past or present generation, treatment, storage, disposal or release of any Hazardous Materials into the environment, have been duly obtained or filed.

Borrower agrees to indemnify and hold the Bank and any Bank Affiliate harmless from all liability, loss, cost, damage and expense, including attorney fees and costs of litigation, arising from any and all of its violations of any Environmental Law (including those arising from any lien by any Federal, state or local government arising from the presence of Hazardous Materials) or from the presence of Hazardous Materials located on or emanating from any Controlled Property or Abutting Property whether existing or not existing and whether known or unknown at the time of the execution hereof and regardless of whether or not caused by, or within the control of Borrower. Borrower further agrees to reimburse Bank upon demand for any costs incurred by Bank in connection with the foregoing. Borrower agrees that its obligations hereunder shall be continuous and shall survive the repayment of all debts to Bank and shall continue so long as a valid claim may be lawfully asserted against the Bank.

The term "Hazardous Materials" includes but is not limited to any and all substances (whether solid, liquid or gas) defined, listed, or otherwise classified as pollutants, hazardous wastes, Hazardous Materials, hazardous materials, extremely hazardous wastes, or words of similar meaning or regulatory effect under any present or future Environmental Law or that may have a negative impact on human health or the environment, including but not limited to petroleum and petroleum products, asbestos and asbestos-containing materials, polychlorinated biphenyls, lead, radon, radioactive materials, flammables and explosives.

The term "Environmental Law" means any present and future Federal, state and local laws, statutes, ordinances, rules, regulations and the like, as well as common law, relating to protection of human health or the environment, relating to Hazardous Materials, relating to liability for or costs of remediation or prevention of releases of Hazardous Materials or relating to liability for or costs of other actual or threatened danger to human health or the environment. The term "Environmental Law" includes, but is not limited to, the following statutes, as amended, any successor thereto, and any regulations promulgated pursuant thereto, and any state or local statutes, ordinances, rules, regulations and the like addressing similar issues: the Comprehensive Environmental Response, Compensation and Liability Act; the Emergency Planning and Community Right-to-Know Act; the Hazardous Materials Transportation Act; the Resource Conservation and Recovery Act (including but not limited to Subtitle I relating to underground storage tanks); the Solid Waste Disposal Act; the Clean Water Act; the Clean Air Act; the Toxic Substances Control Act; the Safe Drinking Water Act; the Occupational Safety and Health Act; the Federal Water Pollution Control Act; the Federal Insecticide, Fungicide and Rodenticide Act; the Endangered Species Act; the National Environmental Policy Act; the River and Harbors Appropriation Act; and the New York Environmental Conservation Law, Chapter 43-B of the New York Consolidated Laws.

#### **4. AFFIRMATIVE COVENANTS**

**4.1 Payments and Performance.** Borrower will duly and punctually pay all Obligations becoming due to the Bank and will duly and punctually perform all Obligations on its part to be done or performed under this Agreement.

**4.2 Books and Records; Inspection.** Borrower will at all times keep proper books of account in which full, true and correct entries will be made of its transactions in accordance with generally accepted accounting principles, consistently applied and which are, in the opinion of a Certified Public Accountant acceptable to Bank, adequate to determine fairly the financial condition and the results of operations of Borrower. Borrower will at all reasonable times make its books and records available in its offices for inspection, examination and duplication by the Bank and the Bank's representatives and will permit inspection of the Collateral and all of its properties by the Bank and the Bank's representatives. Borrower will from time to time furnish the Bank with such information and statements as the Bank may request in its sole discretion with respect to the Obligations or the Bank's security interest in the Collateral. Borrower shall, during the term of this Agreement, keep the Bank currently and accurately informed in writing of each location where Borrower's records relating to its accounts and contract rights are kept, and shall not remove such records to another location without giving the Bank at least thirty (30) days prior written notice thereof.

**4.3 Financial Statements.** Borrower will furnish to Bank:

- (a) Borrower's filed Federal tax returns, including all schedules thereto, for the prior year within 260 days of the end of Borrower's Fiscal Year each such year or by such other date approved by the Bank;
- (b) Posted to Annual 10-K report within 105 days of FYE and 10-Q reports within 60 days of end of Quarter.
- (c) from time to time, such financial data and information about Borrower as Bank may reasonably request; and
- (d) any financial data and information about any guarantors of the Obligations as Bank may reasonably request.

4.4 Conduct of Business. The Borrower will maintain its existence in good standing and comply with all laws and regulations of the United States and of any state or states thereof and of any political subdivision thereof, and of any governmental authority which may be applicable to it or to its business; provided that this covenant shall not apply to any tax, assessment or charge which is being contested in good faith and with respect to which reserves have been established and are being maintained.

4.5 Notice to Account Debtors. The Borrower agrees, at the request of the Bank, to notify all or any of the Debtors in writing of the Bank's security interest in the Collateral in whatever manner the Bank requests and, hereby authorizes the Bank to notify all or any of the Debtors of the Bank's security interest in the Borrower's accounts at the Borrower's expense upon demand for payment plus 5 days.

4.6 Contact with Accountant. The Borrower hereby authorizes the Bank to directly contact and communicate with any accountant employed by Borrower in connection with the review and/or maintenance of Borrower's books and records or preparation of any financial reports delivered by or at the request of Borrower to Bank.

4.7 Operating and Deposit Accounts. The Borrower shall maintain with the Bank its primary operating and deposit accounts. At the option of the Bank, all loan payments and fees will automatically be debited from the Borrower's primary operating account and all advances will automatically be credited to the Borrower's primary operating account.

4.8 Taxes. Borrower will promptly pay all real and personal property taxes, assessments and charges and all franchise, income, unemployment, retirement benefits, withholding, sales and other taxes assessed against it or payable by it before delinquent; provided that this covenant shall not apply to any tax assessment or charge which is being contested in good faith and with respect to which reserves have been established and are being maintained. The Bank may, at its option, from time to time, discharge any taxes, liens or encumbrances of any of the Collateral, and the Borrower will pay to the Bank on demand or the Bank in its sole discretion may charge to the Borrower all amounts so paid or incurred by it.

4.9 Maintenance. Borrower will keep and maintain the Collateral and its other properties, if any, in good repair, working order and condition. Borrower will immediately notify the Bank of any loss or damage to or any occurrence which would adversely affect the value of any Collateral. The Bank may, at its option, from time to time, take any other action that the Bank may deem proper to repair, maintain or preserve any of the Collateral, and the Borrower will pay to the Bank on demand or the Bank in its sole discretion may charge to the Borrower all amounts so paid or incurred by it.

4.10 Insurance. Borrower will maintain in force property and casualty insurance on all Collateral and any other property of the Borrower, if any, against risks customarily insured against by companies engaged in businesses similar to that of the Borrower containing such terms and written by such companies as may be satisfactory to the Bank, such insurance to be payable to the Bank as its interest may appear in the event of loss and to name the Bank as insured pursuant to a standard loss payee clause; no loss shall be adjusted thereunder without the Bank's approval; and all such policies shall provide that they may not be canceled without first giving at least Thirty (30) days written notice of cancellation to the Bank. In the event that the Borrower fails to provide evidence of such insurance, the Bank may, at its option, secure such insurance and charge the cost thereof to the Borrower. At the option of the Bank, all insurance proceeds received from any loss or damage to any of the Collateral shall be applied either to the replacement or repair thereof or as a payment on account of the Obligations. From and after the occurrence of an Event of Default, the Bank is authorized to cancel any insurance maintained hereunder and apply any returned or unearned premiums, all of which are hereby assigned to the Bank, as a payment on account of the Obligations.

4.11 Notification of Default. Immediately upon becoming aware of the existence of any condition or event which constitutes an Event of Default, or any condition or event which would upon notice or lapse of time, or both, constitute an Event of Default, Borrower shall give Bank written notice thereof specifying the nature and duration thereof and the action being or proposed to be taken with respect thereto.

4.12 Notification of Material Litigation. Borrower will immediately notify the Bank in writing of any litigation or of any investigative proceedings of a governmental agency or authority commenced or threatened against it which would or might be materially adverse to the financial condition of Borrower or any guarantor of the Obligations.

4.13 Pension Plans. With respect to any pension or benefit plan maintained by Borrower, or to which Borrower contributes ("Plan"), the benefits under which are guaranteed, in whole or in part, by the Pension Benefit Guaranty Corporation created by the Employee Retirement Income Security Act of 1974, P.L. 93-406, as amended ("ERISA") or any governmental authority succeeding to any or all of the functions of the Pension Benefit Guaranty Corporation ("Pension Benefit Guaranty Corporation"), Borrower will (a) fund each Plan as required by the provisions of Section 412 of the Internal Revenue Code of 1986, as amended; (b) cause each Plan to pay all benefits when due; (c) furnish Bank (i) promptly with a copy of any notice of each Plan's termination sent to the Pension Benefit Guaranty Corporation (ii) no later than the date of submission to the Department of Labor or to the Internal Revenue Service, as the case may be, a copy of any request for waiver from the funding standards or extension of the amortization periods required by Section 412 of the Internal Revenue Code of 1986, as amended and (iii) notice of any Reportable Event as such term is defined in ERISA; and (d) subscribe to any contingent liability insurance provided by the Pension Benefit Guaranty Corporation to protect against employer liability upon termination of a guaranteed pension plan, if available to Borrower.

4.14 Lien Law. If any account or general intangible included in the Collateral represents money owing pursuant to any contract for the improvement of real property or for a public improvement for purposes of the Lien Law of the State of New York (the "Lien Law"), Borrower shall (i) give Bank notice of such fact; (ii) receive and hold any money advanced by Bank with respect to such account or general intangible as a trust fund to be first applied to the payment of trust claims as such term is defined in the Lien Law (Section 71 or otherwise); and (iii) until such trust claim is paid, not use or permit the use of any such money for any purpose other than the payment of such trust claims.

## 5. NEGATIVE COVENANTS

5.1 Financial Covenants. The Borrower will not at any time or during any fiscal period (as applicable) fail to be in compliance with any of the financial covenants in this section.

(a) Definitions. The following definitions shall apply to this Section:

- (i) "GAAP" shall mean generally accepted accounting principles in effect from time to time in the United States.
- (ii) "Intangible Assets" shall mean, as of the date of determination thereof, assets that in accordance with GAAP are properly classifiable as intangible assets, including, but not limited to, goodwill, franchises, licenses, patents, trademarks, trade names and copyrights.
- (iii) "Tangible Net Worth" shall mean, as of the date of determination thereof, total assets (excluding all Intangible Assets, and accounts receivable and/or indebtedness owing from any employee or any parent, subsidiary or other affiliate) less total liabilities plus subordinated debt.

(b) Tangible Net Worth. Minimum Tangible Net Worth of **\$3,000,000** tested annually and semi-annually.

5.2 Limitations on Indebtedness. Borrower shall not issue any evidence of indebtedness or create, assume, guarantee, become contingently liable for, or suffer to exist indebtedness in addition to indebtedness to the Bank, except indebtedness or liabilities of Borrower, other than for money borrowed, incurred or arising in the ordinary course of business.

- 5.3 Sale of Interest. There shall not be any sale or transfer of ownership of any interest in the Borrower without the Bank's prior written consent unless such transfer shall not result in change in control of Borrower.
- 5.4 Loans or Advances. Borrower shall not make any loans or advances to any individual, partnership, corporation, limited liability company, trust, or other organization or person, including without limitation its officers and employees; provided, however, that Borrower may make advances to its employees, including its officers, with respect to expenses incurred or to be incurred by such employees in the ordinary course of business which expenses are reimbursable by Borrower; and provided further, however, that Borrower may extend credit in the ordinary course of business in accordance with customary trade practices.
- 5.5 Dividends and Distributions. Borrower shall not, without prior written consent of the Bank, pay any dividends on or make any distribution on account of any class of Borrower's capital stock in cash or in property (other than additional shares of such stock), or redeem, purchase or otherwise acquire, directly or indirectly, any of such stock, except, so long as Borrower is not in default hereunder, if Borrower is a Subchapter S corporation, under the regulations of the Internal Revenue Service of the United States, distributions to the Shareholders of Borrower in such amounts as are necessary to pay the tax liability of such Shareholders due as a result of such Shareholders' interest in the Borrower.
- 5.6 Investments. The Borrower shall not make investments in, or advances to, any individual, partnership, corporation, limited liability company, trust or other organization or person other than as previously specifically consented to in writing by the Bank. The Borrower will not purchase or otherwise invest in or hold securities, nonoperating real estate or other nonoperating assets or purchase all or substantially all the assets of any entity other than as previously specifically consented to in writing by the Bank except for operating joint ventures in which the company has at least a 25% equity interest.
- 5.7 Merger. Borrower shall not merge or consolidate or be merged or consolidated with or into any other entity without written consent of the Bank.
- 5.8 Capital Expenditures. The Borrower shall not, directly or indirectly, make or commit to make capital expenditures by lease, purchase, or otherwise, except in the ordinary and usual course of business for the purpose of replacing machinery, equipment or other personal property which, as a consequence of wear, duplication or obsolescence, is no longer used or necessary in the Borrower's business except in ordinary course of business.
- 5.9 Sale of Assets. Borrower shall not sell, lease or otherwise dispose of any of its assets, except in the ordinary and usual course of business and except for the purpose of replacing machinery, equipment or other personal property which, as a consequence of wear, duplication or obsolescence, is no longer used or necessary in the Borrower's business, that fair consideration is received therefor; however, in no event shall the Borrower sell, lease or otherwise dispose of any equipment purchased with the proceeds of any loans made by the Bank.
- 5.10 Restriction on Liens. Borrower shall not grant any security interest in, or mortgage of, any of its properties or assets including the Collateral. Borrower shall not enter into any agreement with any person other than the Bank that prohibits the Borrower from granting any security interest in, or mortgage of, any of its properties or assets including the Collateral.
- 5.11 Other Business. Borrower shall not engage in any business other than the business in which it is currently engaged or a business reasonably allied thereto.
- 5.12 Change of Name, etc. Borrower shall not change its legal name or the State or the type of its organization, without giving the Bank at least 30 days prior written notice thereof.

## 6. DEFAULT

**6.1** Default. "Event of Default" shall mean the occurrence of one or more of any of the following events:

- (a) default of any liability, obligation, covenant or undertaking of the Borrower or any guarantor of the Obligations to the Bank, hereunder or otherwise, including, without limitation, failure to pay in full and when due any installment of principal or interest or default of the Borrower or any guarantor of the Obligations under any other Loan Document or any other agreement with the Bank continuing for 15 days with respect to any default (other than with respect to the payment of money for which there is no grace period);
- (b) failure of the Borrower or any guarantor of the Obligations to maintain aggregate collateral security value satisfactory to the Bank continuing for 15 days;
- (c) default of any material liability, obligation or undertaking of the Borrower or any guarantor of the Obligations to any other party continuing for 15 days;
- (d) if any statement, representation or warranty heretofore, now or hereafter made by the Borrower or any guarantor of the Obligations in connection with this Agreement or in any supporting financial statement of the Borrower or any guarantor of the Obligations shall be determined by the Bank to have been false or misleading in any material respect when made;
- (e) if the Borrower or any guarantor of the Obligations is a corporation, trust, partnership or limited liability company, the liquidation, termination or dissolution of any such organization, or the merger or consolidation of such organization into another entity, or its ceasing to carry on actively its present business or the appointment of a receiver for its property;
- (f) the death or judicial declaration of incompetence of the Borrower or any guarantor of the Obligations and, if the Borrower or any guarantor of the Obligations is a partnership or limited liability company, the death or judicial declaration of incompetence of any partner or member;
- (g) the institution by or against the Borrower or any guarantor of the Obligations of any proceedings under the Bankruptcy Code 11 USC §101 *et seq.* or any other law in which the Borrower or any guarantor of the Obligations is alleged to be insolvent or unable to pay its debts as they mature, or the making by the Borrower or any guarantor of the Obligations of an assignment for the benefit of creditors or the granting by the Borrower or any guarantor of the Obligations of a trust mortgage for the benefit of creditors (each of the foregoing in this subclause, an "Insolvency Default");
- (h) the service upon the Bank of a writ in which the Bank is named as trustee of the Borrower or any guarantor of the Obligations;
- (i) a judgment or judgments for the payment of money shall be rendered against the Borrower or any guarantor of the Obligations, and any such judgment shall remain unsatisfied and in effect for any period of thirty (30) consecutive days without a stay of execution;
- (j) any levy, lien (including mechanics lien), seizure, attachment, execution or similar process shall be issued or levied on any of the property of the Borrower or any guarantor of the Obligations continuing for 15 days;

- (k) the termination or revocation of any guaranty of the Obligations; or
- (l) the occurrence of such a change in the condition or affairs (financial or otherwise) of the Borrower or any guarantor of the Obligations, or the occurrence of any other event or circumstance, such that the Bank, in its sole discretion, deems that it is insecure or that the prospects for timely or full payment or performance of any obligation of the Borrower or any guarantor of the Obligations to the Bank has been or may be impaired.

6.2 Acceleration. If an Event of Default shall occur, at the election of the Bank (but automatically in the case of an Insolvency Default), all Obligations shall become immediately due and payable without notice or demand, except with respect to Obligations payable on DEMAND, which shall be due and payable on DEMAND, whether or not an Event of Default has occurred.

The Bank is hereby authorized, at its election, after an Event of Default or after Demand, without any further demand or notice except to such extent as notice may be required by applicable law, to take possession and/or sell or otherwise dispose of all or any of the Collateral at public or private sale; and the Bank may also exercise any and all other rights and remedies of a secured party under the Code or which are otherwise accorded to it in equity or at law, all as Bank may determine, and such exercise of rights in compliance with the requirements of law will not be considered adversely to affect the commercial reasonableness of any sale or other disposition of the Collateral. If notice of a sale or other action by the Bank is required by applicable law, unless the Collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, the Borrower agrees that ten (10) days written notice to the Borrower, or the shortest period of written notice permitted by such law, whichever is smaller, shall be sufficient notice; and that to the extent permitted by law, the Bank, its officers, attorneys and agents may bid and become purchasers at any such sale, if public, and may purchase at any private sale any of the Collateral that is of a type customarily sold on a recognized market or which is the subject of widely distributed standard price quotations. Any sale (public or private) shall be without warranty and free from any right of redemption, which the Borrower shall waive and release after default upon the Bank's request therefor, and may be free of any warranties as to the Collateral if Bank shall so decide. No purchaser at any sale (public or private) shall be responsible for the application of the purchase money. Any balance of the net proceeds of sale remaining after paying all Obligations of the Borrower to the Bank shall be returned to such other party as may be legally entitled thereto; and if there is a deficiency, the Borrower shall be responsible for repayment of the same, with interest. Upon demand by the Bank, the Borrower shall assemble the Collateral and make it available to the Bank at a place designated by the Bank which is reasonably convenient to the Bank and the Borrower. The Borrower hereby acknowledges that the Bank has extended credit and other financial accommodations to the Borrower upon reliance of the Borrower's granting the Bank the rights and remedies contained in this Agreement including without limitation the right to take immediate possession of the Collateral upon the occurrence of an Event of Default or after DEMAND with respect to Obligations payable on DEMAND and the Borrower hereby acknowledges that the Bank is entitled to equitable and injunctive relief to enforce any of its rights and remedies hereunder or under the Code and the Borrower hereby waives any defense to such equitable or injunctive relief based upon any allegation of the absence of irreparable harm to the Bank.

The Bank shall have the unrestricted right from time to time to apply (or to change any application already made of) the proceeds of any of the Collateral to any of the Obligations, as the Bank in its sole discretion may determine.

The Bank shall not be required to marshal any present or future security for (including but not limited to this Agreement and the Collateral subject to the security interest created hereby), or guarantees of, the Obligations or any of them, or to resort to such security or guarantees in any particular order; and all of its rights hereunder and in respect of such securities and guaranties shall be cumulative and in addition to all other rights, however existing or arising. To the extent that it lawfully may do so, the Borrower hereby agrees that it will not invoke and irrevocably waives the benefits of any law relating to the marshaling of collateral which might cause delay in or impede the enforcement of the Bank's rights under this Agreement or under any other instrument evidencing any of the Obligations or under which any of the Obligations is outstanding or by which any of the Obligations is secured or guaranteed. Except as required by applicable law, the Bank shall have no duty as to the collection or protection of the Collateral or any income thereon, nor as to the preservation of rights against prior parties, nor as to the preservation of any rights pertaining thereto beyond the safe custody thereof.

6.3 Power of Attorney. The Borrower hereby irrevocably constitutes and appoints the Bank as the Borrower's true and lawful attorney, with full power of substitution, at the sole cost and expense of the Borrower but for the sole benefit of the Bank, upon the occurrence of an Event of Default or after DEMAND with respect to Obligations payable on DEMAND, to convert the Collateral into cash, including, without limitation, completing the manufacture or processing of work in process, and the sale (either public or private) of all or any portion or portions of the inventory and other Collateral; to enforce collection of the Collateral, either in its own name or in the name of the Borrower, including, without limitation, executing releases or waivers, compromising or settling with any Debtors and prosecuting, defending, compromising or releasing any action relating to the Collateral; to receive, open and dispose of all mail addressed to the Borrower and to take therefrom any remittances or proceeds of Collateral in which the Bank has a security interest; to notify Post Office authorities to change the address for delivery of mail addressed to the Borrower to such address as the Bank shall designate; to endorse the name of the Borrower in favor of the Bank upon any and all checks, drafts, money orders, notes, acceptances or other instruments of the same or different nature; to sign and endorse the name of the Borrower on and to receive as secured party any of the Collateral, any invoices, freight or express receipts, or bills of lading, storage receipts, warehouse receipts, or other documents of title of the same or different nature relating to the Collateral; to sign the name of the Borrower on any notice of the Debtors or on verification of the Collateral; and to sign, if necessary, and file or record on behalf of the Borrower any financing or other statement in order to perfect or protect the Bank's security interest. The Bank shall not be obliged to do any of the acts or exercise any of the powers hereinabove authorized, but if the Bank elects to do any such act or exercise any such power, it shall not be accountable for more than it actually receives as a result of such exercise of power, and it shall not be responsible to the Borrower except for its own gross negligence or willful misconduct. All powers conferred upon the Bank by this Agreement, being coupled with an interest, shall be irrevocable so long as any Obligation of the Borrower or any guarantor or surety to the Bank shall remain unpaid or the Bank is obligated under this Agreement to extend any credit to the Borrower.

6.4 Nonexclusive Remedies. All of the Bank's rights and remedies not only under the provisions of this Agreement but also under any other agreement or transaction shall be cumulative and not alternative or exclusive, and may be exercised by the Bank at such time or times and in such order of preference as the Bank in its sole discretion may determine.

## 7. MISCELLANEOUS

7.1 Waivers. The Borrower waives notice of intent to accelerate, notice of acceleration, notice of nonpayment, demand, presentment, protest or notice of protest of the Obligations, and all other notices, consents to any renewals or extensions of time of payment thereof, and generally waives any and all suretyship defenses and defenses in the nature thereof.

7.2 Waiver of Homestead. To the maximum extent permitted under applicable law, the Borrower hereby waives and terminates any homestead rights and/or exemptions respecting any of its property under the provisions of any applicable homestead laws, including without limitation, Section 5206 of the Civil Practice Law and Rules of New York.

7.3 Deposit Collateral. The Borrower hereby grants to the Bank a continuing lien and security interest in any and all deposits or other sums at any time credited by or due from the Bank or any Bank Affiliate to the Borrower and any cash, securities, instruments or other property of the Borrower in the possession of the Bank or any Bank Affiliate, whether for safekeeping or otherwise, or in transit to or from the Bank or any Bank Affiliate (regardless of the reason the Bank or Bank Affiliate had received the same or whether the Bank or Bank Affiliate has conditionally released the same) as security for the full and punctual payment and performance of all of the liabilities and obligations of the Borrower to the

Bank or any Bank Affiliate and such deposits and other sums may be applied or set off against such liabilities and obligations of the Borrower to the Bank or any Bank Affiliate at any time, whether or not such are then due, whether or not demand has been made and whether or not other collateral is then available to the Bank or any Bank Affiliate.

7.4 Indemnification. The Borrower shall indemnify, defend and hold the Bank and any Bank Affiliate and their directors, officers, employees, agents and attorneys (each an "Indemnitee") harmless of and from any claim brought or threatened against any Indemnitee by the Borrower, any guarantor or endorser of the Obligations, or any other person (as well as from reasonable attorneys' fees and expenses in connection therewith) on account of the Bank's relationship with the Borrower, or any guarantor or endorser of the Obligations (each of which may be defended, compromised, settled or pursued by the Bank with counsel of the Bank's election, but at the expense of the Borrower concerning this agreement and the transaction contemplated in this agreement), except for any claim arising out of the negligence or willful misconduct of the Bank. The within indemnification shall survive payment of the Obligations, and/or any termination, release or discharge executed by the Bank in favor of the Borrower.

7.5 Costs and Expenses. The Borrower shall pay to the Bank on demand any and all costs and expenses (including, without limitation, reasonable attorneys' fees and disbursements, court costs, litigation and other expenses) incurred or paid by the Bank in establishing, maintaining, protecting or enforcing any of the Bank's rights or the Obligations, including, without limitation, any and all such costs and expenses incurred or paid by the Bank in defending the Bank's security interest in, title or right to the Collateral or in collecting or attempting to collect or enforcing or attempting to enforce payment of the Obligations.

7.6 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be an original, but all of which shall constitute but one agreement.

7.7 Severability. If any provision of this Agreement or portion of such provision or the application thereof to any person or circumstance shall to any extent be held invalid or unenforceable, the remainder of this Agreement (or the remainder of such provision) and the application thereof to other persons or circumstances shall not be affected thereby.

7.8 Complete Agreement. This Agreement and the other Loan Documents constitute the entire agreement and understanding between and among the parties hereto relating to the subject matter hereof, and supersedes all prior proposals, negotiations, agreements and understandings among the parties hereto with respect to such subject matter.

7.9 Binding Effect of Agreement. This Agreement shall be binding upon and inure to the benefit of the respective heirs, executors, administrators, legal representatives, successors and assigns of the parties hereto, and shall remain in full force and effect (and the Bank shall be entitled to rely thereon) until released in writing by the Bank. The Bank may transfer and assign this Agreement and deliver the Collateral to the assignee, who shall thereupon have all of the rights of the Bank; and the Bank shall then be relieved and discharged of any responsibility or liability with respect to this Agreement and the Collateral. The Borrower may not assign or transfer any of its rights or obligations under this Agreement. Except as expressly provided herein or in the other Loan Documents, nothing, expressed or implied, is intended to confer upon any party, other than the parties hereto, any rights, remedies, obligations or liabilities under or by reason of this Agreement or the other Loan Documents.

7.10 Further Assurances. Borrower will from time to time execute and deliver to Bank such documents, and take or cause to be taken, all such other or further action, as Bank may request in order to effect and confirm or vest more securely in Bank all rights contemplated by this Agreement and the other Loan Documents (including, without limitation, to correct clerical errors) or to vest more fully in or assure to the Bank the security interest in the Collateral granted to the Bank by this Agreement or to comply with applicable statute or law and to facilitate the collection of the Collateral (including, without limitation, the execution of stock transfer orders and stock powers, endorsement of promissory notes and instruments and notifications to obligors on the Collateral). To the extent permitted by applicable law, Borrower authorizes the Bank to file financing statements, continuation statements or amendments, and any such financing statements, continuation statements or amendments may be filed at any time in any jurisdiction. Bank may at any time and from time to time file financing statements, continuation statements and amendments thereto which contain any information required by the Code for the sufficiency or filing office acceptance of any financing statement, continuation statement or amendment, including whether Borrower is an organization, the type of organization and any organization identification number issued to Borrower. Borrower agrees to furnish any such information to Bank promptly upon request. In addition, Borrower shall at any time and from time to time take such steps as Bank may reasonably request for Bank (i) to obtain an acknowledgment, in form and substance satisfactory to Bank, of any bailee having possession of any of the Collateral that the bailee holds such Collateral for Bank, (ii) to obtain "control" (as defined in the Code) of any Collateral comprised of deposit accounts, electronic chattel paper, letter of credit rights or investment property, with any agreements establishing control to be in form and substance satisfactory to Bank, and (iii) otherwise to insure the continued perfection and priority of Bank's security interest in any of the Collateral and the preservation of its rights therein. Borrower hereby constitutes Bank its attorney-in-fact to execute, if necessary, and file all filings required or so requested for the foregoing purposes, all acts of such attorney being hereby ratified and confirmed; and such power, being coupled with an interest, shall be irrevocable until this Agreement terminates in accordance with its terms, all Obligations are irrevocably paid in full and the Collateral is released.

7.11 Amendments and Waivers. This Agreement may be amended and Borrower may take any action herein prohibited, or omit to perform any act herein required to be performed by it, if Borrower shall obtain the Bank's prior written consent to each such amendment, action or omission to act. No course of dealing and no delay or omission on the part of Bank in exercising any right hereunder shall operate as a waiver of such right or any other right and waiver on any one or more occasions shall not be construed as a bar to or waiver of any right or remedy of Bank on any future occasion.

7.12 Terms of Agreement. This Agreement shall continue in full force and effect so long as any Obligations or obligation of Borrower to Bank shall be outstanding, or the Bank shall have any obligation to extend any financial accommodation hereunder, and is supplementary to each and every other agreement between Borrower and Bank and shall not be so construed as to limit or otherwise derogate from any of the rights or remedies of Bank or any of the liabilities, obligations or undertakings of Borrower under any such agreement, nor shall any contemporaneous or subsequent agreement between Borrower and the Bank be construed to limit or otherwise derogate from any of the rights or remedies of Bank or any of the liabilities, obligations or undertakings of Borrower hereunder, unless such other agreement specifically refers to this Agreement and expressly so provides.

7.13 Notices. Any notice under or pursuant to this Agreement shall be a signed writing or other authenticated record (within the meaning of Article 9 of the Code). Any notices under or pursuant to this Agreement shall be deemed duly received and effective if delivered in hand to any officer or agent of the Borrower or Bank, or if mailed by registered or certified mail, return receipt requested, addressed to the Borrower or Bank at the address set forth in this Agreement or as any party may from time to time designate by written notice to the other party.

7.14 Governing Law. This Agreement shall be governed by the laws of the State of New York without giving effect to the conflicts of laws principles thereof.

7.15 Reproductions. This Agreement and all documents which have been or may be hereinafter furnished by Borrower to the Bank may be reproduced by the Bank by any photographic, photostatic, microfilm, xerographic or similar process, and any such reproduction shall be admissible in evidence as the original itself in any judicial or administrative proceeding (whether or not the original is in existence and whether or not such reproduction was made in the regular course of business).

7.16 Joint and Several. If more than one Borrower signs this Agreement, then the responsibilities hereunder are joint and several.

7.17 Completing and Correcting this Agreement. The Borrower authorizes the Bank to fill in any blank spaces and to otherwise complete this Agreement and to correct any patent errors herein.

7.18 **ADDITIONAL WAIVERS. IN ANY ACTION, SUIT OR PROCEEDING IN RESPECT OF OR ARISING OUT OF THIS AGREEMENT, BORROWER WAIVES (i) THE RIGHT TO INTERPOSE ANY SET-OFF OR COUNTERCLAIM OF ANY NATURE OR DESCRIPTION, (ii) ANY OBJECTION BASED ON FORUM NON CONVENIENS OR VENUE AND (iii) ANY CLAIM FOR CONSEQUENTIAL, PUNITIVE OR SPECIAL DAMAGES.**

7.19 **Increased Costs.** If any law, regulation or guideline or any change therein or interpretation or application thereof by any regulatory body, court, administrative or governmental authority charged with the interpretation or administration thereof, or compliance with any request, directive, ruling, decree, judgment or recommendation of any regulatory body, court administrative or governmental authority now existing or hereafter adopted (whether or not having the force of law) imposes, modifies or deems applicable, any capital adequacy, increased capital adequacy or similar requirement and the result is to increase the cost of, or reduce the rate of return on, the Bank's (or Bank affiliate's or participant's) capital as a consequence of its obligations hereunder, the Bank shall notify the Borrower of such fact. The Borrower and the Bank shall thereafter in good faith negotiate an adjustment to the fees payable hereunder which, in the reasonable judgment of the Borrower and the Bank, will adequately compensate the Bank (or Bank affiliate or participant) in light of these circumstances. In the event that the Borrower and the Bank are unable to agree on such adjustment within 30 days after the date on which the Bank sends such notice to the Borrower, the Borrower shall on the later of such 30th day after notice or the date such increased cost or reduced return takes effect, unless otherwise agreed to by the Bank (or Bank affiliate or participant), prepay all loans on the 35th day.

7.20 **USA Patriot Act.** The Bank is subject to the requirements of the USA Patriot Act (Title III of Pub. L. 107-56 (signed into law October 26, 2001)) (the "Patriot Act") and hereby notifies Borrower that pursuant to the requirements of the Patriot Act, it is required to obtain, verify and record information that identifies the Borrower, which information includes the name and address of the Borrower and other information that will allow such Bank to identify the Borrower in accordance with the Patriot Act.

7.21 **Sharing of Borrower Financial Information.** The Borrower authorizes the Bank to share Borrower's financial information to facilitate only an appraisal in connection with any Real Property securing the Obligation(s).

7.22 **Jurisdiction and Venue.** Borrower irrevocably submits to the nonexclusive jurisdiction of any Federal or state court sitting in New York, over any suit, action or proceeding arising out of or relating to this Agreement. Borrower irrevocably waives, to the fullest extent it may effectively do so under applicable law, any objection it may now or hereafter have to the laying of the venue of any such suit, action or proceeding brought in any such court and any claim that the same has been brought in an inconvenient forum. Borrower hereby consents to any and all process which may be served in any such suit, action or proceeding, (i) by mailing a copy thereof by registered and certified mail, postage prepaid, return receipt requested, to the Borrower's address shown in this Agreement or as notified to the Bank and (ii) by serving the same upon the Borrower in any other manner otherwise permitted by law, and agrees that such service shall in every respect be deemed effective service upon Borrower.

7.23 **JURY WAIVER. THE BORROWER AND BANK EACH HEREBY KNOWINGLY, VOLUNTARILY AND INTENTIONALLY, AND AFTER AN OPPORTUNITY TO CONSULT WITH LEGAL COUNSEL, (A) WAIVE ANY AND ALL RIGHTS TO A TRIAL BY JURY IN ANY ACTION OR PROCEEDING IN CONNECTION WITH THIS AGREEMENT, THE OBLIGATIONS, ALL MATTERS CONTEMPLATED HEREBY AND DOCUMENTS EXECUTED IN CONNECTION HERewith AND (B) AGREE NOT TO SEEK TO CONSOLIDATE ANY SUCH ACTION WITH ANY OTHER ACTION IN WHICH A JURY TRIAL CANNOT BE, OR HAS NOT BEEN, WAIVED. THE BORROWER CERTIFIES THAT NEITHER THE BANK NOR ANY OF ITS REPRESENTATIVES, AGENTS OR COUNSEL HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT THE BANK WOULD NOT IN THE EVENT OF ANY SUCH PROCEEDING SEEK TO ENFORCE THIS WAIVER OF RIGHT TO TRIAL BY JURY.**

Executed as of \_\_\_\_\_, **2013.**

Signature Verified:

Borrower:

Chembio Diagnostic Systems, Inc.

By: \_\_\_\_\_

Name:

Title:

By: \_\_\_\_\_

Name:

Title:

**CERTIFICATION**

I, Lawrence A. Siebert, certify that:

1. I have reviewed this Form 10-Q of Chembio Diagnostics, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2013

/s/ Lawrence A. Siebert  
Lawrence A. Siebert, Chief Executive Officer

**CERTIFICATION**

I, Richard J. Larkin, certify that:

1. I have reviewed this Form 10-Q of Chembio Diagnostics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2013

/s/ Richard J. Larkin  
Richard J. Larkin, Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q (the "Report") of Chembio Diagnostics, Inc. (the "Company") for the quarter ended June 30, 2013, each of the undersigned Lawrence A. Siebert, the Chief Executive Officer of the Company, and Richard J. Larkin, the Chief Financial Officer of the Company, hereby certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of the undersigneds' knowledge and belief:

(1) This Form 10-Q for the quarter ended June 30, 2013 fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in this Form 10-Q for the quarter ended June 30, 2013 fairly presents, in all material respects, the financial condition and results of operations of Chembio Diagnostics, Inc. for the periods presented therein.

Dated: August 8, 2013

/s/ Lawrence A. Siebert  
Lawrence A. Siebert  
Chief Executive Officer

Dated: August 8, 2013

/s/ Richard J. Larkin  
Richard J. Larkin  
Chief Financial Officer

## EMPLOYMENT AGREEMENT

The Employment Agreement (the "Agreement") is entered into as of the 22nd day of May, 2013 (the "Effective Date"), by and between Chembio Diagnostics, Inc., a Nevada corporation (the "Company"), and Sharon Klugewicz ("Employee"). Employee and the Company are sometimes referred to individually as a "Party" and collectively as the "Parties".

In consideration of the mutual covenants, promises and agreements herein contained, the Company and Employee hereby covenant, promise and agree to and with each other as follows:

1. Employment. The Company shall employ Employee and Employee shall perform services for and on behalf of the Company upon the terms and conditions set forth in this Agreement.

2. Positions and Duties of Employment. Employee shall be required to devote her full energy, skill and best efforts as required to the furtherance of her managerial duties with the Company as the Company's Chief Operating Officer. While serving in such capacities, Employee shall have the responsibilities, duties, obligations, rights, benefits and requisite authority as is customary for her position and as may be determined by the Company's Board of Directors (the "Board").

Employee understands that her employment as Chief Operating Officer of the Company involves a high degree of trust and confidence, that she is employed for the purpose of furthering the Company's reputation and improving the Company's operations and profitability, and that in executing this Agreement she undertakes the obligations set forth herein to accomplish such objectives. Employee agrees that she shall serve the Company fully, diligently, competently and to the best of her ability. Employee certifies that she fully understands her right to discuss this Agreement with her attorney, that she has availed herself of this right to the extent that she desires, that she has carefully read and fully understands this entire Agreement, and that she is voluntarily entering into this Agreement.

3. Duties. Employee shall perform the following services for the Company:

(a) Employee shall serve as Chief Operating Officer of the Company, or in such other position as determined by the Board, and in those capacities shall work with the Company to pursue the Company's plans as directed by the Board.

(b) Employee shall perform duties with the functions of an officer of the Company, subject to the direction of the Board.

(c) During the Term (as defined in Section 4 below) of this Agreement, Employee shall devote substantially all of Employee's business time to the performance of Employee's duties under this Agreement. Without limiting the foregoing, Employee shall perform services on behalf of the Company for at least forty hours per week, and Employee shall be reasonably available at the request of the Company at other times, including weekends and holidays, to meet the needs and requests of the Company's customers.

(d) During the Term, Employee will not engage in any other activities or undertake any other commitments that conflict with or take priority over Employee's responsibilities and obligations to the Company and the Company's customers, including without limitation those responsibilities and obligations incurred pursuant to this Agreement.

4. Term. Unless terminated earlier as provided for in this Agreement, the term of this Agreement shall be for two years, commencing on the Effective Date and ending on the second anniversary of the Effective Date (the "Term"). If the employment relationship is terminated by either Party, Employee agrees to cooperate with the Company and with the Company's new management with respect to the transition of the new management in the operations previously performed by Employee. Upon Employee's termination, Employee agrees to return to the Company all Company documents (and all copies thereof), any other Company property in Employee's possession or control, and any materials of any kind that contain or embody any proprietary or confidential material of the Company.

5. Compensation. As compensation for the services to be performed by Employee during the Term, Company shall pay Employee the following a compensation:

(a) A base salary at an annual rate of \$250,000, subject to periodic review by the Board or the Compensation Committee of the Board (the "Committee"), payable in accordance with the Company's customary payroll practices (the "Base Salary").

(b) A performance-based bonus (the "Performance Bonus") of up to 37.5% of the Base Salary, to be comprised of the same components in the same ratios as for the Company's other executive officers.

6. Stock Option Grant.

(a) Grant of Stock Options. In recognition of Employee's importance and value to the Company and as an additional inducement for Employee to enter into this Agreement, but subject in all respects to the terms and conditions of this Agreement, including, without limitation, the vesting schedule set forth below, and the Company's 2008 Stock and Incentive Plan (the "Plan") and the Company's form of Stock Option Agreement annexed hereto as Exhibit C, the Company hereby grants to

Employee on the later of the Effective Date or the date that this Agreement has been signed by the Employee and the Company (for purposes of this Section 9, the "Stock Option Grant Date"), stock options to purchase 5,000 shares (the "Options") of the Company's common stock, \$0.01 par value per share (the "Common Stock"), which are intended to be incentive stock options under the Plan and within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended. The price per share of the Options shall be equal to the Fair Market Value (as such term is defined below) of the Common Stock on the Stock Option Grant Date. For purposes of this Agreement, the term "Fair Market Value" shall mean the closing price of the Common Stock on the Stock Option Grant Date on the National Association of Securities Dealers Automated Quotation System ("NASDAQ"). Subject to the terms and conditions of this Agreement, two thousand five hundred (2,500) of the Options shall vest on each of the first and second anniversaries of the Stock Option Grant Date. Any other stock options previously granted to Ms. Klugewicz by the Company will remain effective according to their original terms and provisions.

(b) No Proportionate or Partial Vesting. There shall be no proportionate or partial vesting of the Options between the vesting dates set forth in subparagraph 6(a) above.

(c) Restrictions on Transfer. Employee shall not exercise, sell, transfer, pledge, hypothecate, assign or otherwise encumber or dispose of the Options, except as set forth in this Agreement. Any attempted exercise, sale, transfer, pledge, hypothecation, assignment or other disposition of the Options in violation of this Agreement shall be void and of no effect. The provisions of this Section 6(c) shall cease to apply to the Options on the date such Options become vested hereunder.

(d) Forfeiture; Immediate Vesting. If Employee's employment is terminated by Employee at any time other than during the six (6) month period immediately following a Change of Control (as such term is hereinafter defined) or by the Company for Cause (as such term is hereinafter defined), then Employee will forfeit, without compensation, any and all Options that are unvested as of the date of termination of Employee's employment. In the event of a Change of Control or in the event the Company terminates Employee's employment hereunder without her consent for a reason other than Cause, then all of the Options shall vest immediately.

#### 7. Certain Additional Provisions Relating to Compensation and Other Employee Benefits.

(a) If Employee is eligible, the Company shall include Employee in any profit sharing plan, executive stock option plan, pension plan, retirement plan, medical and/or hospitalization plan, and/or any and all other benefit plans, except for disability and life insurance, which may be placed in effect by the Company for the benefit of the Company's executive officers during the Term. Except for the fact that the Company at all times shall provide Employee with all or at least a portion of Employee's medical and/or hospitalization insurance, which shall not be less than that afforded to the Company's other executive officers, nothing in this Agreement shall limit (i) the Company's ability to exercise the discretion provided to it under any such benefit plan, or (ii) the Company's discretion to adopt, not adopt, amend or terminate any such benefit plan at any time.

(b) Employee shall be entitled to four (4) weeks vacation leave for each year of the Term, as well as sick leave, medical insurance coverage and any other benefits consistent with the Company's plans and policies in effect for the Company's executives from time to time. The Company may modify in its sole and absolute discretion such benefits from time to time as it considers necessary or appropriate.

(c) During the Term, Employee shall be reimbursed for reasonable expenses that are authorized by the Company and that are incurred by Employee for the benefit of the Company in accordance with the standard reimbursement practices of the Company. Any direct payment or reimbursement of expenses shall be made only upon presentation of an itemized accounting conforming in form and content to standards prescribed by the Internal Revenue Service relative to the substantiation of the deductibility of business expenses.

(d) Any payments which the Company shall make to Employee pursuant to this Agreement shall be reduced by standard withholding and other applicable payroll deductions, including, without limitation, federal, state or local income or other taxes, social security and medicare taxes, state unemployment insurance deductions, state disability insurance deductions, and any other applicable tax or deduction (collectively, any withheld taxes and deductions, "Deductions").

#### 8. Confidentiality.

(a) Employee hereby warrants, covenants and agrees that, without the prior express written consent of the Company, and unless required by law, court order or similar process, Employee shall hold in the strictest confidence, and shall not disclose to any person, firm, corporation or other entity, any and all of the Company's information, including, for example, and without limitation, any data related to (i) drawings, sketches, plans or other documents concerning the Company's business or development plans, customers or suppliers, and research and development efforts; (ii) the Company's development, design, construction or sales and marketing methods or techniques; or (iii) the Company's trade secrets and other "know-how" or information not of a public nature, regardless of how such information came to the custody of Employee (collectively, subsections (i), (ii) and (iii) of this Section 8(a), "Information"). For purposes of this Agreement, such Information shall include, but not be limited to, any information regarding a formula, pattern, compilation, program, device, method, technique or process that (A) derives independent economic value, present or potential, not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (B) is the subject of Company efforts.

(b) In the event Employee is required by law, court order or similar process to disclose any Information, Employee shall provide immediate notice of such obligatory disclosure prior to such disclosure, so that the Company, at its sole option, may attempt to seek a protective order or other appropriate remedy to preclude such disclosure.

(c) The warranties, covenants and agreements set forth in this Section 8 shall not expire, shall survive this Agreement, and shall be binding upon Employee without regard to the passage of time or any other event.

9. Company's Right To Inventions and Discoveries

(a) "Inventions" means all improvements, discoveries, inventions, works of authorship, mask works, computer programs, source and object codes, writings, formulas, ideas, processes, techniques, know-how and data, made or conceived or reduced to practice or developed by Employee, either alone or jointly with others as a result of employment at the Company. "Proprietary Rights" means all trade secret, patent, copyright, trademark, trade name, service mark, and other intellectual property rights throughout the world. Inventions and Proprietary Rights do not include inventions that the Employee developed entirely on Employee's own time without using the Company's equipment, supplies, facilities, or Information except for those inventions that either relate to the Company's actual or anticipated business, research or development or that result from work performed by the Employee for the Company.

(b) Employee hereby assigns and agrees to assign in the future to the Company all of Employee's right, title and interest in and to any and all Inventions and all Proprietary Rights, whether or not subject to protection under the patent, copyright, trademark or industrial design laws, made or conceived or reduced to practice or learned by Employee (solely or jointly with others) during Employee's employment with the Company (including, without limitation such employment prior to the Effective Date) and for a one-year period after Employee's termination of employment with the Company (collectively "Assigned Intellectual Property"). Employee further agrees that all Assigned Intellectual Property is the sole property of the Company.

(c) Employee agrees to promptly notify and fully disclose to the Company all Assigned Intellectual Property, and will take such steps as are deemed necessary to maintain complete and current records of same. Employee will, at the Company's request and expense, whether during or after employment, take such steps as are reasonably necessary to assist the Company in securing, maintaining, defending or enforcing any title and right to Assigned Intellectual Property.

10. Non-Compete. Employee acknowledges and recognizes the highly competitive nature of the Company's business and that Employee's duties hereunder justify restricting Employee's further employment following any termination of employment. Employee further acknowledges and understands that the Company recognizes Employee's importance and value to the Company and thus has provided Employee with the overall compensation package described hereunder in order to induce Employee to enter into this Agreement. Accordingly, Employee agrees that so long as Employee is employed by the Company, and (i) for a period of two (2) years following the termination of this Agreement, Employee shall not induce or attempt to induce any employee of the Company to leave the employ of the Company, or in any way interfere with the relationship between the Company and any other employee; (ii) for a period of one (1) year following the termination of this Agreement, Employee, except when acting at the request of the Company on behalf of or for the benefit of the Company, shall not induce customers, agents or other sources of distribution of the Company's business under contract or doing business with the Company to terminate, reduce, alter or divert business with or from the Company; and (iii) for a period of one (1) year following the termination of this Agreement, Employee shall not, directly or indirectly, either as a principal, agent, employee, employer, consultant, partner, member or manager of a limited liability company, shareholder of a company that does not have securities registered under the Securities Exchange Act of 1934 (the "1934 Act"), or a shareholder in excess of one (1%) percent of a company that has securities registered under the 1934 Act, corporate officer or director, or in any other individual or representative capacity, engage or otherwise participate in any manner or fashion in any business that directly competes with the business activities of the Company in or about any market in which the Company is, or has publicly announced a plan for doing business. Employee further covenants and agrees that the restrictive covenants set forth in this paragraph are reasonable as to duration, terms, and geographical area and that the same protects the legitimate interests of the Company, imposes no undue hardship on Employee, and is not injurious to the public. The covenant set forth under (iii) above shall not apply if Employee's employment is terminated within twelve (12) months of a Change in Control. Ownership by Employee, for investment purposes only, of less than one (1%) percent of any class of securities of a corporation if said securities are listed on a national securities exchange or registered under the 1934 Act shall not constitute a breach of the covenant set forth under (iii) above. Employee acknowledges and understands that, by virtue of her position with the Company, she will have exposure to various entities with which the Company does business or is in discussions to do business. Accordingly, Employee hereby covenants and agrees that, so long as she is employed by the Company, she will not, except with the prior written consent of the Company, solicit or enter into any discussions for a position of employment with any such entities. It is the desire and intent of the Parties that the provisions of this paragraph be enforced to the fullest extent permissible under the laws and public policies applied in each jurisdiction in which enforcement is sought. Accordingly, if any particular portion of this paragraph shall be adjudicated to be invalid or enforceable, this paragraph shall be deemed amended to apply in the broadest allowable manner and to delete therefrom the portion adjudicated to be invalid or unenforceable, such amendment and deletion to apply only with respect to the operation of this paragraph in the particular jurisdiction in which that adjudication is made.

11. Internal Revenue Code Section 409A ("409A") Matters. this Agreement is intended to comply with 409A any ambiguous provisions will be construed in a manner that is compliant with or exempt from the application of 409A. If a provision of the Agreement would result in the imposition of an applicable tax under 409A, the parties agree that such provision shall be reformed to avoid imposition of the applicable tax, with such reformation effected in a manner that has the most favorable result to Employee.

(a) For purposes of 409A, each payment or amount due under this Agreement shall be considered a separate payment, and Employee's entitlement to a series of payments under this Agreement is to be treated as an entitlement to a series of separate payments.

(b) If (x) Employee is a "specified employee," as such term is defined in 409A and determined as described below in this Paragraph 11(b), and (y) any payment due under this Agreement is subject to 409A and is required to be delayed under 409A because Employee is a specified employee, that payment shall be payable on the earlier of (A) the first business day that is six months after Employee's separation from service, as such term is defined in 409A, (B) the date of Employee's death, or (C) the date that otherwise complies with the requirements of 409A. This Paragraph 11(b) shall be applied by accumulating all payments that otherwise would have been paid within six months of Employee's separation and paying such accumulated amounts on the earliest business day which complies with the requirements of 409A. For purposes of determining the identity of specified employees, the Board may establish procedures as it deems appropriate in accordance with 409A.

## 12. Termination.

(a) If Employee's employment is terminated by the Company without Cause, or if Employee terminates her employment for Reasonable Basis (as defined below), then the Company shall, in exchange for Employee's execution of a general release and waiver of claims against the Company as of the termination date in a form reasonably acceptable to the Company, continue to pay as severance Employee's Base Salary for a period of six (6) months following the date such general release and waiver of claims is executed. Such payments shall be made in accordance with the Company's customary payroll practices, and shall be subject to all applicable Deductions. In the event of any such termination set forth in this Section 12(a), Employee will not be entitled to any additional cash compensation or benefits beyond what is provided in the first sentence of this Section 12(a).

(i) For purposes of this Agreement, "Cause" shall mean that the Board, acting in good faith based upon the information then known to the Company, determines that Employee has engaged in or committed any of the following: (A) willful misconduct, gross negligence, theft, fraud, or other illegal conduct; (B) refusal or unwillingness to perform Employee's duties; (C) performance by Employee of Employee's duties determined by the Board to be inadequate in a material respect; (D) breach of any applicable non-competition provision, confidentiality provision or other proprietary information or inventions agreement between Employee and the Company; (E) inappropriate conflict of interest; (F) insubordination; (G) failure to follow the directions of the Board or any committee thereof; (H) any other material breach of this Agreement. In addition, an indictment or conviction of any felony, or any entry of a plea of nolo contendere, under the laws of the United States or any State shall be considered "Cause" hereunder. "Cause" shall be specified in a notice of termination to be delivered by the Company to Employee no later than the date as of which termination is effective.

(ii) For purposes of this Agreement, "Reasonable Basis" shall mean (A) a material breach of this Agreement by the Company, provided, however, that Employee shall provide written notice to the Company of any alleged material breach, and any alleged material breach will only be considered a material breach if the Company fails to cure such breach within thirty days after receiving notice of such breach; (B) termination of Employee's employment by the Company without Cause during the term hereof; (C) a reduction in Employee's salary, except to the extent that a majority of the other executive officers of the Company incur reductions of salary that average no less than the percentage reduction incurred by Employee; or (D) termination of Employee's employment by Employee within six (6) months after a "Change of Control," which is defined as any of the following:

(1) any consolidation or merger of the Company in which the Company is not the continuing or surviving corporation, other than a merger of the Company in which the holders of the Company's voting common stock immediately prior to the merger own a majority of the voting common stock of the surviving corporation immediately after the merger;

(2) any sale, lease, exchange or other transfer (in one transaction or a series of related transactions) of all or substantially all the assets of the Company;

(3) any approval by the stockholders of the Company of any plan or proposal for the liquidation or dissolution of the Company;

(4) the acquisition by any person or entity, or any group of persons and/or entities of a majority of the stock entitled to elect a majority of the directors of the Company; or

(5) subject to applicable law, in a Chapter 11 bankruptcy proceeding, the appointment of a trustee or the conversion of a case involving the Company to a case under a Chapter 7 bankruptcy proceeding.

(b) In the event that Employee's employment with the Company is terminated for Cause, by reason of Employee's death or disability, or due to Employee's resignation or voluntary termination (other than for a Reasonable Basis), then all compensation (including, without limitation, any Base Salary, and the right to receive a Performance Bonus, and benefits, and the vesting of any unvested Restricted Options, will cease as of the effective date of such termination, and Employee shall receive

no severance benefits, or any other compensation; provided that Employee shall be entitled to receive all compensation earned and all benefits and reimbursements due through the effective date of termination.

(c) Employee agrees that the payments contemplated by this Agreement shall constitute the exclusive and sole remedy for any termination of employment, and Employee covenants not to assert or pursue any other remedies, at law or in equity, with respect to any termination of employment.

(d) Any Party terminating this Agreement shall give prompt written notice to the other Party hereto advising such other Party of the termination of this Agreement stating in reasonable detail the basis for such termination (the "Notice of Termination"). The Notice of Termination shall indicate whether termination is being made for Cause (if the Company has terminated the Agreement) or for a Reasonable Basis (if Employee has terminated the Agreement).

13. Remedies. If there is a breach or threatened breach of any provision of Section 8, 9, 10, or 12 of this Agreement, the Company will suffer irreparable harm and shall be entitled to an injunction restraining Employee from such breach. Nothing herein shall be construed as prohibiting the Company from pursuing any other remedies for such breach or threatened breach.

14. Severability. It is the clear intention of the Parties to this Agreement that no term, provision or clause of this Agreement shall be deemed to be invalid, illegal or unenforceable in any respect, unless such term, provision or clause cannot be otherwise construed, interpreted, or modified to give effect to the intent of the Parties and to be valid, legal or enforceable. The Parties specifically charge the trier of fact to give effect to the intent of the Parties, even if in doing so, invalidation of a specific provision of this Agreement is required to make the Agreement consistent with the foregoing stated intent. In the event that a term, provision, or clause cannot be so construed, interpreted or modified, the validity, legality and enforceability of the remaining provisions contained herein and other application(s) thereof shall not in any way be affected or impaired thereby and shall remain in full force and effect.

15. Waiver of Breach. The waiver by the Company or Employee of the breach of any provision of this Agreement by the other Party shall not operate or be construed as a waiver of any subsequent breach by that Party.

16. Entire Agreement. this document contains the entire agreement between the Parties and supersedes all prior oral or written agreements, if any, concerning the subject matter hereof or otherwise concerning Employee's employment by the Company (except with respect to shares, and options to purchase shares, of the Company's Common Stock previously granted to Employee). this Agreement may not be changed orally, but only by a written agreement signed by both Parties.

17. Governing Law. this Agreement, its validity, interpretation and enforcement, shall be governed by the laws of the State of New York, excluding conflict of laws principles. Employee hereby expressly consents to personal jurisdiction in the state and federal courts located in Suffolk County, NY for any lawsuit filed there against him by the Company arising from or relating to this Agreement.

18. Notices. Any notice pursuant to this Agreement shall be validly given or served if that notice is made in writing and delivered personally or sent by certified mail or registered, return receipt requested, postage prepaid, to the following addresses:

If to Company: Chembio Diagnostics, Inc.  
3661 Horseblock Road, Suite A  
Medford, NY 11763  
Attention: President

If to Employee: To the address for Employee set forth below her signature.

All notices so given shall be deemed effective upon personal delivery or, if sent by certified or registered mail, five business days after date of mailing or, if sent by overnight courier, one business day after dispatch. Either Party, by notice so given, may change the address to which her or its future notices shall be sent.

19. Assignment and Binding Effect. this Agreement shall be binding upon Employee and the Company and shall benefit the Company and its successors and assigns. this Agreement shall not be assignable by Employee.

20. Headings. The headings in this Agreement are for convenience only; they form no part of this Agreement and shall not affect its interpretation.

21. Construction. Employee represents she has (a) read and completely understands this Agreement and (b) had an opportunity to consult with such legal and other advisers as she has desired in connection with this Agreement. this Agreement shall not be construed against any one of the Parties.

22. Directors' and Officers' Insurance. The Company is to maintain directors' and officers' insurance in an amount reasonably determined by the Board.

23. Key Man Insurance. The Company has purchased, or may purchase, one or more "key man" insurance policies on Employee's life, each of which will be payable to and owned by the Company. The Company, in its sole discretion, may select the amount and type of key man life insurance purchased, and Employee will have no interest in any such policies. Employee will cooperate with the Company in securing and maintaining this key man insurance by submitting to all required medical examinations, supplying all information and executing all documents required in order for the Company to secure and maintain the insurance.

**IN WITNESS WHEREOF**, the Parties have caused this Agreement to be executed on the day and year set forth below to be effective as of \_\_\_\_\_, 2013.

Employee:

Company:

Chembio Diagnostics, Inc.

\_\_\_\_\_  
Sharon Klugewicz, Individually  
\_\_\_\_\_  
\_\_\_\_\_

By: \_\_\_\_\_  
Lawrence A. Siebert, Chief Executive Officer

Date: \_\_\_\_\_

Date: \_\_\_\_\_