

**Management's Discussion & Analysis**

**For the year ended May 31, 2011**

**BIOQUAL, INC.**

**Prepared by:**

**David Newcomer  
Chief Financial Officer**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION**

### Highlights

In fiscal year 2011, which ended on May 31, 2011, BIOQUAL realized net income of \$401,662, a 3.5% decrease compared to net income of \$416,415 for fiscal year 2010, for the reasons discussed below.

During fiscal year 2011, under the Indefinite Delivery / Indefinite Quantity task order oriented type contract with the National Institute of Allergy and Infectious Diseases (NIAID) entitled "Animal Care and Laboratory Support Services", the company was awarded four task orders totaling \$1,877,777. The contract is currently in Option Year 2 (out of 4 total option years) which ends on July 15, 2012. There are, however, no assurances that BIOQUAL will be awarded any other task orders under this contract.

On May 24, 2011, BIOQUAL was awarded an Indefinite Delivery / Indefinite Quantity task order oriented type contract with the Department of Health and Human Services (DHHS) entitled "Biologics Animal Model Development". The Company was approved to bid on tasks under the five year Master Agreement. The Agreement guarantees a minimum of \$50,000 in revenues by year five and has a maximum limit of \$7,500,000. To date, the Company has not submitted any proposals under this contract. The Company plans to present proposals for task orders requesting services relevant to its expertise. There are, however, no assurances that BIOQUAL will be awarded any task orders under this contract.

On May 31, 2011, BIOQUAL was awarded an Indefinite Delivery / Indefinite Quantity task order oriented type contract with the NIAID entitled "In Vitro Assessment for Antimicrobial Activity - Part B". The Company was approved to bid on tasks under Part B of the seven year Master Agreement. Part B guarantees a minimum of \$25,000 in revenues by year seven and has the maximum limit of \$25,000,000. The Company was recently awarded a task order for \$42,264 to perform certain assays between September 30, 2011 and September 29, 2012. There are, however, no assurances that BIOQUAL will be awarded any additional task orders under this contract.

On September 10, 2010, the Board of Directors declared a cash dividend based on fiscal year 2010 earnings of \$.16 per share for shareholders of record on September 21, 2010. The dividend was paid on October 12, 2010.

On November 15, 2010, The Board of Directors promoted Dr. Mark Lewis to President of the Company. Dr. John Landon continues as Chief Executive Officer and Chairman of the Board.

### Department of Endocrinology and Toxicology (DET)

In the past year, BIOQUAL updated its website to include its endocrinology and toxicology capabilities and has been marketing these capabilities. In December 2010, the Company attended The

International Society of Regulatory Toxicology and Pharmacology 2010 Endocrine Workshop: Endocrine Disruptor Screening Program (EDSP) Compliance at the National Institutes of Health. The workshop provided analyses of the status and content of the EDSP. BIOQUAL attendees concluded that for at least the next several months there will be a low level of assay opportunities. As a result of this conclusion, Management decided to reduce expenditures in support of this venture and thus reassigned selected staff and implemented a limited reduction of personnel. The Company continues to be able to reinstate its capability to capture a portion of the market. There can be, however, no assurance that the Company will, if it reinstates its efforts to provide the EPA assays, capture any portion of the market.

## Results of Operations

### Results of Operations 2011 versus 2010

The \$484,341 decrease in revenues for the year ended May 31, 2011 to \$23,298,689, compared to \$23,783,030 for the year ended May 31, 2010 is primarily comprised of three components. The first component is a net decrease of \$1,175,543 in government contract activity due to the termination of one contract ("Biological Testing Facility") as discussed in the Management's Discussion and Analysis for the year ended May 31, 2010, and a significant decrease in contract activity of a second contract. The second component is a net decrease of \$359,735 in grant subcontract revenue reflecting a decrease in award activity during fiscal year 2011 compared to fiscal year 2010. The third component is a net increase of \$1,050,937 in commercial contract revenue primarily reflecting additional subcontracts awarded to, and operating at BIOQUAL during fiscal year 2011 compared to fiscal year 2010.

The \$567,513 decrease in contract operating expenses for fiscal year 2011 primarily reflects the net decrease in contract activity mentioned above offset by an increase in costs related to the efforts of the DET as described above of approximately \$218,000. General and administrative expenses increased \$82,608 compared to fiscal year 2010 primarily due to a net increase in administrative labor costs net of the effect of the reclassification of labor incurred by the DET as contract operating expenses in fiscal year 2011 compared to including these costs in G&A in fiscal year 2010, legal expenses related to a Department of Labor questionnaire response and consultant expenses related to improving laboratory practices.

The \$564 increase in operating income primarily reflects Management's efforts to control indirect costs resulting in a higher profit margin on fixed price contracts compared to the prior fiscal year. The increased profit on fixed price contracts was partially offset by a decrease in fee collected on government contracts and an increase in the costs related to supporting the DET, compared to the previous fiscal year.

## Liquidity and Capital Resources

During fiscal year 2011, BIOQUAL directed approximately \$399,000

towards capital expenditures. These expenditures are necessary to provide additional equipment for research being performed in the Company's laboratories. BIOQUAL has been able to continue to fund all of these expenditures through the use of existing cash provided by profits and its line of credit.

During the next six months, the Company estimates the aggregate purchase price of equipment to upgrade older equipment or enhance its capabilities to be approximately \$75,000.

Other than the items mentioned above, BIOQUAL does not currently anticipate other substantial capital expenditures during fiscal year 2012. However, if the Company is awarded new contracts that require additional equipment or cages during that period, the Company believes it will have sufficient capital resources to provide for the purchase of the equipment. Additionally, whether or not the expired contract is replaced, the Company believes it will have sufficient capital resources to provide for its continuing daily operations.

BIOQUAL has a \$500,000 line of credit with M&T Bank available to help cover costs of its daily operations. The line of credit is due on demand, renewable annually and was renewed in May, 2011. As of May 31, 2011, there was no balance on the line of credit. As of May 31, 2011, the interest rate on funds drawn on the line of credit is the prime rate plus .25%, which as of May 31, 2011 was 3.50%. On May 31, 2011, the Company had a balance of cash and cash equivalents of \$2,719,179. With the above line of credit and the cash resources expected to be available as a result of collection of accounts receivable, the Company believes it will have sufficient capital resources to provide for daily operations until the end of fiscal year 2012.

Other balance sheet items worth noting are: 1) the \$1,894,006 increase in accounts receivable primarily reflects \$1,049,254 in new commercial contracts (4 contracts) and expanded existing commercial contracts (4 contracts) that were awarded and advance billed in late May 2011, an increase of \$684,606 in unbilled indirect rate variances resulting from actual overhead expenses exceeding overhead expenses billed during fiscal year 2011 and an increase of \$211,141 in accrued sales compared to the previous fiscal year end, 2) a \$197,769 increase in accounts payable reflecting the purchase of nonhuman primates for three of the new commercial contracts awarded during May 2011 as mentioned above, and 3) an increase in deferred revenue of \$702,806 primarily reflecting the advance billing of the new and expanded commercial contracts awarded during May 2011. Refer to the Statements of Consolidated Cash Flows on Pages 7 and 8 of the audited financial statements available on BIOQUAL's website [www.bioqual.com](http://www.bioqual.com) for further details related to the changes in cash and cash equivalents.

#### Forward Looking Information

Statements herein that are not descriptions of historical facts are forward-looking and subject to risk and uncertainties. Actual results could differ materially from those currently anticipated

due to a number of factors including risks relating to the ability to continue to extend current government contracts and obtain new contracts; and the Company's ability to perform under its contracts in accordance with the requirements of the contracts; the actual cost incurred in performing its contracts and the Company's ability to manage its costs; uncertainties relating to clinical trials; dependence on third parties; future capital needs; the ability to fund its capital needs through the use of its cash on hand and line of credit; and the future availability and cost of financing/capital sources to the Company.