

BIOQUAL, INC. AND SUBSIDIARY

**AUDITED CONSOLIDATED
FINANCIAL STATEMENTS**

MAY 31, 2010 AND 2009

Bioqual, Inc. and Subsidiary

Table of Contents

	Page
Independent Auditor's Report	1
Audited Consolidated Financial Statements	
Consolidated Balance Sheets	2 - 3
Consolidated Statements of Income	4
Consolidated Statements of Stockholders' Equity	5
Consolidated Statements of Cash Flows	6 - 7
Notes to Consolidated Financial Statements	8 - 14

Independent Auditor's Report

Board of Directors
Bioqual, Inc.
Rockville, Maryland

We have audited the accompanying Consolidated Balance Sheets of **Bioqual, Inc. and Subsidiary** as of May 31, 2010 and 2009, and the related Consolidated Statements of Income, Stockholders' Equity and Cash Flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of **Bioqual, Inc. and Subsidiary** as of May 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Aronson & Company

Rockville, Maryland
August 11, 2010

<i>May 31,</i>	2010	2009
Assets		
Current assets		
Cash and cash equivalents	\$ 3,152,624	\$ 2,917,774
Accounts receivable - contracts, net	5,217,939	4,742,415
Prepaid income taxes	13,032	171,721
Prepaid expenses	79,193	67,441
Deferred income taxes	81,900	90,000
Total current assets	8,544,688	7,989,351
Property and equipment		
Leasehold improvements	2,944,835	2,893,746
Furniture, fixtures and equipment	8,521,272	8,361,376
Total property and equipment	11,466,107	11,255,122
Less: Accumulated depreciation and amortization	(8,571,043)	(7,762,332)
Net property and equipment	2,895,064	3,492,790
Other assets		
Cash surrender value of officers' life insurance	793,559	748,002
Total assets	\$ 12,233,311	\$ 12,230,143

Bioqual, Inc. and Subsidiary

Consolidated Balance Sheets

	2010	2009
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 400,963	\$ 328,599
Accrued compensation and related liabilities	930,599	1,213,146
Deferred revenue	159,500	135,987
Total current liabilities	1,491,062	1,677,732
Long term liabilities		
Deferred rent	448,523	421,670
Deferred income taxes	130,600	206,800
Total long term liabilities	579,123	628,470
Total liabilities	2,070,185	2,306,202
Commitments and contingencies		
Stockholders' equity		
Preferred stock - par value \$1.00 per share; 500,000 shares authorized; no shares issued and outstanding	-	-
Common stock - par value \$0.01 per share, 25,000,000 shares authorized, 1,600,408 shares issued; 901,750 and 904,872 shares outstanding, respectively	16,004	16,004
Treasury stock, at cost	(981,497)	(946,466)
Additional paid-in capital	7,328,380	7,325,799
Retained earnings	3,800,239	3,528,604
Total stockholders' equity	10,163,126	9,923,941
Total liabilities and stockholders' equity	\$ 12,233,311	\$ 12,230,143

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

Bioqual, Inc. and Subsidiary

Consolidated Statements of Income

<i>Years Ended May 31,</i>	2010	2009
Contract revenue	\$ 23,783,030	\$ 28,247,895
Operating expenses		
Contract	19,305,928	22,119,547
General and administrative	3,799,825	3,940,769
Total operating expenses	23,105,753	26,060,316
Operating income	677,277	2,187,579
Interest income, net	(6,449)	(31,473)
Income before income taxes	683,726	2,219,052
Provision for income taxes	267,311	896,843
Net income	\$ 416,415	\$ 1,322,209
Basic earnings per share	\$ 0.46	\$ 1.46
Diluted earnings per share	\$ 0.46	\$ 1.46
Weighted average number of shares outstanding for basic earnings per share	903,951	903,428
Effective of dilutive securities - stock options	-	918
Weighted average number of shares outstanding for diluted earnings per share	903,951	904,346

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

Bioqual, Inc. and Subsidiary

Consolidated Statements of Stockholders' Equity

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings	Total
	Shares	Amount	Shares	Amount			
Balance, June 1, 2008	1,600,408	\$ 16,004	703,870	\$ (953,928)	\$ 7,320,222	\$ 2,351,041	\$ 8,733,339
Exercise of stock options	-	-	(8,334)	7,462	5,577	-	13,039
Dividends declared - \$0.16 per share	-	-	-	-	-	(144,646)	(144,646)
Net income	-	-	-	-	-	1,322,209	1,322,209
Balance, May 31, 2009	1,600,408	16,004	695,536	(946,466)	7,325,799	3,528,604	9,923,941
Repurchase of common stock	-	-	3,422	(35,300)	-	-	(35,300)
Grant of common stock	-	-	(300)	269	2,581	-	2,850
Dividends declared - \$0.16 per share	-	-	-	-	-	(144,780)	(144,780)
Net income	-	-	-	-	-	416,415	416,415
Balance, May 31, 2010	1,600,408	\$ 16,004	698,658	\$ (981,497)	\$ 7,328,380	\$ 3,800,239	\$ 10,163,126

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

Bioqual, Inc. and Subsidiary

Consolidated Statements of Cash Flows

<i>Years Ended May 31,</i>	2010	2009
Cash flows from operating activities		
Net income	\$ 416,415	\$ 1,322,209
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	808,711	815,513
Deferred income taxes	(68,100)	108,800
Stock compensation	2,850	-
Change in cash surrender value of officers' life insurance	16,707	17,003
(Increase) decrease in		
Accounts receivable - contracts	(475,524)	(30,564)
Prepaid expenses	(11,752)	77,633
Increase (decrease) in		
Accounts payable	72,364	(280,472)
Accrued compensation and related liabilities	(282,547)	177,921
Deferred revenue	23,513	(114,013)
Income taxes payable	158,689	(65,236)
Deferred rent	26,853	(65,665)
Net cash provided by operating activities	688,179	1,963,129
Cash flows from investing activities		
Purchases of property and equipment	(210,985)	(675,419)
Payment on officers' life insurance	(62,264)	(62,264)
Net cash used by investing activities	(273,249)	(737,683)
Cash flows from financing activities		
Dividends paid	(144,780)	(144,646)
Repurchase of common stock	(35,300)	-
Proceeds from exercise of stock options	-	13,039
Net cash used by financing activities	(180,080)	(131,607)

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

Bioqual, Inc. and Subsidiary

Consolidated Statements of Cash Flows (Continued)

<i>Years Ended May 31,</i>	2010	2009
Net change in cash and cash equivalents	234,850	1,093,839
Cash and cash equivalents at beginning of year	2,917,774	1,823,935
Cash and cash equivalents at end of year	\$ 3,152,624	\$ 2,917,774
Supplemental information:		
Income taxes paid	\$ 176,722	\$ 1,025,000

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

Bioqual, Inc. and Subsidiary

Notes to Consolidated Financial Statements

-
1. **Organization and significant accounting policies** **Organization:** Bioqual, Inc., a Delaware Corporation, was founded in 1981. The Company supports the National Institutes of Health by providing research services in the following research areas: cancer, AIDS, hepatitis, influenza, immunology, transgenics, contraception, breeding and development of genetically defined animals, and neurobiology and behavior.

Principles of consolidation: The accompanying consolidated financial statements include the accounts of Bioqual, Inc. and its wholly-owned subsidiary, Enhanced Therapeutics, Inc. (collectively, the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

Use of accounting estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue: Revenue from cost-type contracts is recognized as costs are incurred on the basis of direct costs plus allowable indirect costs and an allocable portion of the fixed fee. Revenue from fixed-price type contracts is recognized under the percentage-of-completion method of accounting, with costs and estimated profits included in contract revenue as work is performed. If actual and estimated costs to complete a contract indicate a loss, provision is made currently for the loss anticipated on the contract. Revenue from time and materials contracts is recognized as costs are incurred at amounts represented by the agreed-upon billing amounts. As soon as it is determined that it is probable a contract will result in a loss and the loss can be reasonably estimated, the entire loss is charged to operations.

Revenue recognized on contracts for which billings have not been presented to customers at year end is included in the accounts receivable - contracts classification on the accompanying consolidated balance sheets.

Revenue yet to be recognized on contracts for which billings have been presented to customers is reflected in the accompanying consolidated balance sheets as deferred revenue.

Cash and cash equivalents: Cash and cash equivalents consist of financial instruments with original maturities of less than three months. At times, the Company's cash balances may exceed Federally insured limits. The Company does not believe that this results in any significant risk.

Bioqual, Inc. and Subsidiary

Notes to Consolidated Financial Statements

Government contracts: Substantially all of the Company's revenue is from U.S. Government contracts (primarily the National Institutes of Health). The indirect rates used in cost-plus-fixed-fee contracts are subject to final negotiated settlements for each fiscal year. In management's opinion, final settlement of indirect rates will not have a material effect on the Company's financial position or results of operations when settled. The Company does not require collateral for its government billings and does not consider its accounts receivable to be a significant risk.

Accounts receivable: The Company provides for an allowance for doubtful accounts based on management's best estimate of possible losses determined principally on the basis of historical experience and specific allowances for known troubled accounts, if needed. All accounts, or portions thereof that are deemed to be uncollectible or that require an excessive collection cost are written off to the allowance for doubtful accounts. At May 31, 2010 and 2009, management deemed all accounts receivable to be collectible.

Property and equipment: Property and equipment are recorded at the original cost and are being depreciated on a straight-line basis over estimated lives of three to ten years. Leasehold improvements are amortized over the life of the assets or the remaining period of the lease, whichever is shorter.

Income taxes: Current income tax expense is the amount of income taxes expected to be payable for the current year. Deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable earnings. Valuation allowances are established when necessary to reduce deferred tax assets to the amount more likely than not to be realized.

The Company evaluates uncertainty in income tax positions based on a more-likely-than-not recognition standard. If that threshold is met, the tax position is then measured at the largest amount that is greater than 50% likely of being realized upon ultimate settlement. As of May 31, 2010 and 2009, there are no accruals for uncertain tax positions. If applicable, the Company records interest and penalty as a component of income tax expense. Tax years from May 31, 2007 through the current year remain open for examination by Federal and state tax authorities.

Fair value of financial instruments: The carrying amounts of obligations approximate their fair value due to the short-term nature or their underlying terms.

Bioqual, Inc. and Subsidiary

Notes to Consolidated Financial Statements

Earnings per share: The Company calculates basic and diluted earnings per share. Basic earnings per share is calculated using the weighted-average number of common shares outstanding during the period. Diluted earnings per share is calculated using the weighted-average number of common shares plus dilutive potential common shares outstanding during the period. Potential common shares consist of stock options.

Stock based compensation: The Company measures compensation expense for its stock based compensation plan under principles which require that compensation expense be recorded in operations. The value of the option grants is determined at the grant date and recognized over the requisite service period.

Subsequent events: Management has evaluated subsequent events for disclosure in these financial statements through August 11, 2010, which is the date the financial statements are available to be issued.

2. Accounts receivable

Accounts receivable at May 31, 2010 and 2009, consist of amounts due under contracts in progress with Federal government agencies, primarily the National Institutes of Health. The components of accounts receivable are:

	<u>2010</u>	<u>2009</u>
Billed receivables	\$ 3,328,404	\$ 3,893,478
Unbilled receivables	1,889,535	848,937
Total	\$ 5,217,939	\$ 4,742,415

Of the total receivables outstanding as of May 31, 2010 and 2009, approximately 67% and 71%, are due from two and three customers, respectively. Additionally, the Company has three customers that generated approximately 73% and 82% of total contract revenue for the years ended May 31, 2010 and 2009, respectively.

3. Note payable - line of credit

The Company has a line of credit arrangement with a bank which is due on demand. At May 31, 2010 and 2009, the maximum amount available under the arrangement was \$500,000 and \$1,200,000, respectively and the Company had no outstanding balance under the agreement. The line bears interest at the bank's prime rate plus .25% (3.50% at May 31, 2010) and is collateralized by all assets of the Company. The line of credit contains various financial covenants which include maintaining certain ratios of cash flow to required debt service and debt to tangible net worth as well as maintaining minimum tangible net worth. The Company was in compliance with the financial covenants as of May 31, 2010 and 2009.

Bioqual, Inc. and Subsidiary

Notes to Consolidated Financial Statements

4. **Income taxes** For the years ended May 31, 2010 and 2009, the components of the provision for income taxes consisted of:

	2010	2009
Current tax expense	\$ 335,411	\$ 788,043
Deferred tax (benefit) expense	(68,100)	108,800
Provision for income taxes	\$ 267,311	\$ 896,843

The provision for income taxes for the years ended May 31, 2010 and 2009 reflected in the accompanying consolidated statements of income varies from the amount which would have been computed using statutory rates as follows:

	2010	2009
Federal taxes at statutory rate	\$ 232,000	\$ 754,000
State taxes at statutory rate, net of federal tax benefit	37,000	121,000
Permanent differences and other	(1,689)	21,843
Provision for income taxes	\$ 267,311	\$ 896,843

The net deferred income tax asset (liability) represents an estimate of the income tax that will be recoverable (due) in future periods from the cumulative temporary differences recognized for financial reporting purposes from that recognized for income tax reporting purposes. At May 31, 2010 and 2009, the components of these temporary differences and the deferred tax asset (liability) were as follows:

	2010	2009
Financial statement accruals	\$ 81,900	\$ 90,000
Different methods of depreciation of fixed assets for tax purposes	(130,600)	(208,100)
Research and development costs deferred for tax purposes	-	1,300
Total deferred income taxes	\$ (48,700)	\$ (116,800)
Current deferred income tax asset	\$ 81,900	\$ 90,000
Long-term deferred income tax liability	(130,600)	(206,800)
Net deferred tax asset (liability)	\$ (48,700)	\$ (116,800)

Bioqual, Inc. and Subsidiary

Notes to Consolidated Financial Statements

5. Operating leases

The Company is obligated, as lessee, under non-cancelable operating leases covering its facilities and certain equipment and vehicles expiring at various dates through 2015. One of the three facility leases provides an option to renew for five years. Another facility lease provides for two successive five-year renewal options. Some of the leases provide for annual increases. A deferred rent liability is recorded for the difference between the pro-rata expense recognized and the total amounts paid to date under the leases.

The following is a schedule by years of future minimum rental payments required under the operating leases that have an initial or remaining non-cancelable lease term in excess of one year as of May 31, 2010:

Year Ending May 31	Total
2011	\$ 3,192,066
2012	3,246,957
2013	1,122,740
2014	1,150,565
2015	4,732
Total	\$ 8,717,060

Total rent expense for the years ended May 31, 2010 and 2009 was approximately \$3,061,000 and \$2,975,000, respectively.

Bioqual, Inc. and Subsidiary

Notes to Consolidated Financial Statements

- 6. Contract status** **Provisional indirect cost rates:** Billings under cost-based government contracts are calculated using provisional rates which permit recovery of indirect costs. These rates are subject to audit on an annual basis by the government agencies' cognizant audit agency. The cost audits will result in the negotiation and determination of the final indirect cost rates which the Company may use for the years audited. The final rates, if different from the provisional rates, may create a receivable or a liability.

As of May 31, 2010, the Company had negotiated final settlements on indirect cost rates through 2007. The Company periodically reviews its cost estimates and experience rates, and adjustments, if needed, are made and reflected in the period in which the estimates are revised. In the opinion of management, redetermination of any cost-based contracts for the open years will not have any material effect on the Company's financial position or results of operations.

The Company has authorized but uncompleted contracts in progress at May 31, 2010, approximately as follows:

Total contract price of initial contract awards including modifications, exercised options, and approved change orders	\$ 39,213,000
Completed to date	(35,053,000)
<hr/>	
Authorized backlog	\$ 4,160,000

The foregoing contracts contain unexercised options and unfunded amounts not reflected in the above amounts totaling approximately \$43,216,000 at May 31, 2010.

7. Retirement plan

The Company sponsors a tax deferred savings plan to provide retirement benefits for all eligible employees under the Internal Revenue Code. The Company's annual contribution to the plan is based on eligible employee participation. Participating employees may voluntarily contribute a percentage of their annual salaries, not to exceed certain limits provided by the Code. The Company may make discretionary matches of each participant's contribution. Rights to benefits provided by the Company's contributions vest 20% each year after the second year of service. Participants are fully vested in their voluntary contributions. The Company's contributions for the years ended May 31, 2010 and 2009, were \$77,410 and \$120,003 respectively.

Bioqual, Inc. and Subsidiary

Notes to Consolidated Financial Statements

- 8. Stock options** The Company granted options to purchase shares of its common stock under its 1988 and 1998 stock option plans. The 1998 stock option plan was authorized to grant options to purchase up to 83,333 shares of common stock. The options expired ten years from the date of grant under the plan, or upon the optionee's separation from the Company and were granted at the average of the closing bid and ask price of the Company's common stock at the date of the grant. Both the 1988 and 1998 plan were terminated in accordance with their terms and conditions.

Options exercised during the year ended May 31, 2009, had an aggregate intrinsic value (fair value less option exercise price) of \$100,594. The Company received cash of \$13,039 related to the exercise of the options in 2009. There was no tax benefit recognized as the options qualified as incentive stock options. The Company issues shares from treasury upon the exercise of stock options.

The following table summarizes activity in the stock option plans for the years ended May 31, 2010 and 2009:

	Number of Options	Weighted Average Option Price Per Share
Options outstanding, June 1, 2008	8,334	\$ 1.56
Options exercised	(8,334)	1.56
<hr/>		
Options outstanding, May 31, 2009 and May 31, 2010	-	\$ -

- 9. Commitments and contingencies** The Company has an employment agreement with its President which provides for a base compensation and additional incentive compensation dependent upon annual operations. On July 10, 2007, the agreement was renewed for an additional five years.