

Unaudited Financial Statements and Management's Discussion & Analysis  
For the quarterly period ended November 30, 2010

BIOQUAL, INC.

Prepared by:

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BIOQUAL, INC.

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BIOQUAL, INC. AND SUBSIDIARY

UNAUDITED CONSOLIDATED BALANCE SHEETS, NOVEMBER 30, 2010 AND MAY 31, 2010

<u>ASSETS</u>	<u>November 30, 2010</u>	<u>May 31, 2010</u>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 2,003,813	\$ 3,152,624
Accounts receivable:		
Trade	3,802,662	3,328,404
Unbilled - current	2,352,332	1,889,535
Prepaid Income Taxes	99,932	13,032
Prepaid expenses	160,772	79,193
Deferred income taxes - current	<u>81,900</u>	<u>81,900</u>
Total current assets	<u>8,501,411</u>	<u>8,544,688</u>
<b>FIXED ASSETS:</b>		
Leasehold improvements	2,970,626	2,944,835
Furniture, fixtures and equipment	<u>8,553,154</u>	<u>8,521,272</u>
Total	11,523,780	11,466,107
Less accumulated depreciation and amortization	<u>8,978,631</u>	<u>8,571,043</u>
Fixed assets, net	<u>2,545,149</u>	<u>2,895,064</u>
CASH VALUE OF OFFICERS' LIFE INSURANCE POLICIES	<u>793,559</u>	<u>793,559</u>
<b>TOTAL</b>	<b><u>\$ 11,840,119</u></b>	<b><u>\$ 12,233,311</u></b>
<b><u>LIABILITIES</u></b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	339,586	400,963
Accrued compensation and related liabilities	625,950	930,599
Deferred Revenue	<u>226,956</u>	<u>159,500</u>
Total current liabilities	<u>1,192,492</u>	<u>1,491,062</u>
Deferred rent	402,311	448,523
Deferred income tax liability - non current	<u>130,600</u>	<u>130,600</u>
Total liabilities	<u>1,725,403</u>	<u>2,070,185</u>
<b><u>STOCKHOLDERS' EQUITY</u></b>		
Preferred stock - par value of \$1.00 per share; 500,000 shares authorized; no shares issued and outstanding		
Common stock - par value of \$.01 per share; 25,000,000 shares authorized; 1,600,408 shares issued; 901,750 and 901,750 shares outstanding, respectively	16,004	16,004
Additional paid-in capital	7,328,380	7,328,380
Retained earnings	<u>3,751,829</u>	<u>3,800,239</u>
Total	11,096,213	11,144,623
Less - treasury stock, at cost	<u>(981,497)</u>	<u>(981,497)</u>
Total stockholders' equity	<u>10,114,716</u>	<u>10,163,126</u>
<b>TOTAL</b>	<b><u>\$ 11,840,119</u></b>	<b><u>\$ 12,233,311</u></b>

See Management's Discussion and Analysis.

BIOQUAL, INC. AND SUBSIDIARY  
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED NOVEMBER 30,

	<u>2010</u>	<u>2009</u>
REVENUES:		
Contract revenues	\$ 6,018,335	\$ 5,864,727
Total Revenues	<u>6,018,335</u>	<u>5,864,727</u>
OPERATING EXPENSES:		
Contract	4,905,356	4,860,795
General and administrative	<u>936,167</u>	<u>933,642</u>
Total Operating Expenses	<u>5,841,523</u>	<u>5,794,437</u>
OPERATING INCOME	176,812	70,290
INTEREST INCOME	217	0
INTEREST EXPENSE	<u>0</u>	<u>(49)</u>
INCOME BEFORE INCOME TAXES	177,029	70,241
PROVISION FOR INCOME TAXES	<u>(70,100)</u>	<u>(29,600)</u>
NET INCOME	<u>\$ 106,929</u>	<u>\$ 40,641</u>
BASIC EARNINGS PER SHARE	<u>\$ 0.12</u>	<u>\$ 0.04</u>
DILUTED EARNINGS PER SHARE	<u>\$ 0.12</u>	<u>\$ 0.04</u>
WEIGHTED AVERAGE NUMBER OF SHARES		
OUTSTANDING FOR BASIC EARNINGS SHARE	901,750	904,716
EFFECT OF DILUTIVE SECURITIES - OPTIONS	<u>0</u>	<u>0</u>
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR DILUTED EARNINGS PER SHARE	<u>901,750</u>	<u>904,716</u>

See Management's Discussion and Analysis.

BIOQUAL, INC. AND SUBSIDIARY  
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE SIX MONTHS ENDED NOVEMBER 30,

	<u>2010</u>	<u>2009</u>
REVENUES:		
Contract revenues	<u>\$11,473,649</u>	<u>\$12,002,018</u>
Total Revenues	<u>11,473,649</u>	<u>12,002,018</u>
OPERATING EXPENSES:		
Contract	9,388,111	9,683,786
General and administrative	<u>1,920,404</u>	<u>1,998,361</u>
Total Operating Expenses	<u>11,308,515</u>	<u>11,682,147</u>
OPERATING INCOME	165,134	319,871
INTEREST INCOME	836	3,170
INTEREST EXPENSE	<u>0</u>	<u>(60)</u>
INCOME BEFORE INCOME TAXES	165,970	322,981
PROVISION FOR INCOME TAXES	<u>(70,100)</u>	<u>(136,600)</u>
NET INCOME	<u>\$ 95,870</u>	<u>\$ 186,381</u>
BASIC EARNINGS PER SHARE	<u>\$ 0.11</u>	<u>\$ 0.21</u>
DILUTED EARNINGS PER SHARE	<u>\$ 0.11</u>	<u>\$ 0.21</u>
WEIGHTED AVERAGE NUMBER OF SHARES		
OUTSTANDING FOR BASIC EARNINGS SHARE	901,750	904,795
EFFECT OF DILUTIVE SECURITIES - OPTIONS	<u>0</u>	<u>0</u>
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR DILUTED EARNINGS PER SHARE	<u>901,750</u>	<u>904,795</u>

See Management's Discussion and Analysis.

BIOQUAL, INC. AND SUBSIDIARY  
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE SIX MONTHS ENDED NOVEMBER 30,

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$ 95,870	\$ 186,381
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	407,588	405,428
(Increase) decrease in		
Accounts receivable	(937,055)	(420,804)
Prepaid expenses	(168,479)	5,431
Increase (decrease) in		
Accounts payable and accrued expenses	(366,026)	(467,935)
Deferred rent	(46,212)	7,750
Deferred revenue	67,456	372,923
NET CASH (USED BY) PROVIDED BY OPERATING ACTIVITIES	<u>(946,858)</u>	<u>89,174</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net capital expenditures	<u>(57,673)</u>	<u>(41,482)</u>
NET CASH USED BY INVESTING ACTIVITIES	<u>(57,673)</u>	<u>(41,482)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment for stock purchased from former employee	0	(8,224)
Dividend paid	<u>(144,280)</u>	<u>(144,780)</u>
NET CASH USED BY FINANCING ACTIVITIES	<u>(144,280)</u>	<u>(153,004)</u>
NET (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,148,811)	(105,312)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>3,152,624</u>	<u>2,917,774</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$2,003,813</u>	<u>\$2,812,462</u>

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the period for:

Interest	<u>\$ 0</u>	<u>\$ 11</u>
Income Taxes	<u>\$ 157,000</u>	<u>\$ 76,722</u>

See Management's Discussion and Analysis.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

### Interim Financial Statements

In the opinion of management, all adjustments consisting only of normal recurring accruals necessary for a fair presentation of such amounts have been included. The results of operations for the quarter are not necessarily indicative of results for the year.

### Highlights

In the second quarter of fiscal year 2011 which commenced on September 1, 2010, BIOQUAL realized a net income of \$106,929, a 163.1% increase compared to a net income of \$40,641 for the second quarter of fiscal year 2010. Net income for the six months of fiscal year 2011 totaled \$95,870, a 48.6% decrease compared to the net income of \$186,381 for the first six months of fiscal year 2010.

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 will continue as Chief Executive Officer and Chairman of the Board.

### Department of Endocrinology and Toxicology (DET)

In the report for the fiscal year that ended May 31, 2010, we stated that the Environmental Protection Agency (EPA) under section 408(p) of the Federal Food, Drug and Cosmetics Act established the Endocrine Disruptor Screening Program (EDSP) and issued the first test orders for pesticide chemicals to be screened for their potential effects on the endocrine system. No new test orders have since been issued, and none seem to be expected for a while. It is anticipated that a new list of 100 chemicals will eventually be published. Until issued, commercial evaluation of the compounds will be delayed. Since the previous annual report BIOQUAL has been able to evaluate several of the primary test protocols proposed by the EPA. As stated in the Management's Discussion and Analysis for the year ended May 31, 2010, BIOQUAL was repeating selected assays proposed by the EPA exactly to EPA protocol specifications as well as evaluating in-house protocols that might be more effectively used for end results.

BIOQUAL has updated its website to include its capabilities has been marketing these capabilities. The Company attended The International Society of Regulatory Toxicology and Pharmacology 2010 Endocrine Workshop: EDSP Compliance in December 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 has decided to reduce expenditures in support of this venture by reassigning selected staff and implementing a limited reduction of personnel. The Company has positioned itself 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

### Three Month Comparison

The \$153,608 increase in revenues for the quarter ended November 30, 2010, to \$6,018,335 compared to \$5,864,727 for the quarter ended November 30, 2009, primarily reflects a net increase of approximately \$630,000 in commercial contract activity as a result of an influx of new commercial projects starting in this quarter compared to a lesser number of new commercial work in the second quarter of the previous fiscal year. The increase in commercial revenues was partially off-set by a decrease of approximately \$250,000 in government contract activity due to the fiscal year 2010 termination of one contract ("Biological Testing Facility") as discussed in the Management's Discussion and Analysis for the year ended May 31, 2010, and an approximate decrease of \$225,000 in grant sub award activity during this quarter compared to the second quarter of the previous fiscal year.

The \$44,561 increase in contract operating expenses for the quarter ended November 30, 2010, primarily reflects the increase of costs related to the efforts of the DET as described above of approximately \$262,000. However, those costs are primarily offset by the net decrease in overhead expenses resulting from action Management has taken to improve corporate profitability. General and administrative (G&A) expenses increased \$2,525 compared to the second quarter of fiscal year 2009 primarily due to an increase in administrative labor costs, legal expenses related to a Department of Labor questionnaire response and consultant expenses related to improving laboratory practices. The increases were virtually offset by the decrease in administrative labor costs resulting from the reclassification of labor incurred by the DET as contract operating expenses in fiscal year 2011 compared to G&A in the second quarter of fiscal year 2010.

### Six Month Comparison

The \$528,369 decrease in revenues for the six months ended November 30, 2010, to \$11,473,649 compared to \$12,002,018 for the six months ended November 30, 2009, primarily reflects a net decrease of approximately \$940,000 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. Additionally, another cause of the decrease in revenues is the approximate decrease of \$400,000 in grant sub award activity during the first six months of fiscal year 2011 compared to the same period in the

previous fiscal year. An approximate increase in revenues of \$811,000 in commercial contracts helped offset some of the decreases above.

The \$295,675 decrease in contract operating expenses for the six months ended November 30, 2010, primarily reflects the net decrease in contract activity mentioned above offset by the costs related to the efforts of the DET as described above of approximately \$530,000. General and administrative (G&A) expenses decreased \$77,957 compared to the first six months of fiscal year 2010 primarily due to a decrease in administrative labor costs resulting from 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.

### Liquidity and Capital Resources

During the first six months of fiscal year 2011, BIOQUAL directed approximately \$58,000 towards capital expenditures. These expenditures were necessary to provide modern 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 maintain state of the art laboratories and facilities and animal enclosures to be approximately \$300,000.

Other than the items mentioned above, BIOQUAL does not currently anticipate other substantial capital expenditures during fiscal year 2011. However, if the Company is awarded new contracts that require additional equipment or animal enclosures during that period, the Company believes it will have sufficient capital resources to provide for the purchase of the equipment.

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 March, 2010. As of November 30, 2010, there was no balance on the line of credit. The interest rate on funds drawn on the line of credit is the prime rate plus .25%, which as of November 30, 2010, was 3.50%. On November 30, 2010, the Company had a balance of cash on hand of \$2,003,813. 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.

Other balance sheet items worth noting are: 1) the \$304,649 decrease in accrued compensation and related liabilities primarily reflects a shorter accrual period this quarter compared to the prior year end and the payment of the accrued fiscal year 2010 bonuses during the first quarter of fiscal year 2011, 2) the \$81,579 increase in prepaid expenses reflects prepayment of annual liability and workers compensation insurance premiums and real estate taxes, and 3) the net \$937,055 increase in accounts

receivable primarily reflects the \$462,797 increase in unbilled indirect rate variances resulting from actual indirect expenses exceeding provisional indirect expenses during fiscal year 2011 and an approximately \$474,258 increase in trade receivables reflecting a slower than normal collections rate and an influx of new commercial contracts during the second quarter of fiscal year 2011. Refer to the Statements of Consolidated Cash Flows on Page 5 for further detail 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.