**Unaudited Financial Statements and Management's Discussion & Analysis**

**For the quarterly period ended November 30, 2017**

**BIOQUAL, INC.**

**Prepared by:**

**David Newcomer**
**Chief Financial Officer**

**BIOQUAL, INC.**

## INDEX

BIOQUAL, INC. AND SUBSIDIARY

UNAUDITED CONSOLIDATED BALANCE SHEETS, NOVEMBER 30, 2017 AND MAY 31, 2017

| ASSETS | November 30, 2017 | May 31, 2017 |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 7,967,399 | $ 9,288,447 |
| Accounts receivable: | | |
| Trade | 7,809,066 | 6,498,760 |
| Unbilled - current | 968,062 | 1,777,618 |
| Prepaid expenses | 453,002 | 258,103 |
| Income taxes receivable | 235,033 | 77,733 |
| Total current assets | 17,432,562 | 17,900,661 |
| FIXED ASSETS: | | |
| Leasehold improvements | 4,665,190 | 4,516,584 |
| Furniture, fixtures and equipment | 9,474,843 | 8,445,039 |
| Total | 14,140,033 | 12,961,623 |
| Less accumulated depreciation and amortization | (10,359,760) | (10,013,672) |
| Fixed assets, net | 3,780,273 | 2,947,951 |
| OTHER ASSETS: | | |
| Other intangibles, net | 31,585 | 36,707 |
| Deferred income taxes | 76,200 | 76,200 |
| Goodwill | 1,028,408 | 1,028,408 |
| Cash value of officers' life insurance policies | 769,937 | 769,937 |
| Total other assets | 1,906,130 | 1,911,252 |
| TOTAL | $ 23,118,965 | $ 22,759,864 |
| LIABILITIES | | |
| CURRENT LIABILITIES: | | |
| Note payable, current portion | 317,214 | 317,214 |
| Accounts payable | 1,304,900 | 1,241,025 |
| Accrued compensation and related liabilities | 757,973 | 1,332,178 |
| Deferred revenue | 150,838 | 209,193 |
| Total current liabilities | 2,530,925 | 3,099,610 |
| Note payable, net of current portion | 93,390 | 250,115 |
| Deferred rent | 601,572 | 494,973 |
| Total liabilities | 3,225,887 | 3,844,698 |
| STOCKHOLDERS' EQUITY | | |
| 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; 1,599,408 shares issued; 894,416 and 893,416 shares outstanding | 15,994 | 15,994 |
| Additional paid-in capital | 7,326,328 | 7,326,328 |
| Retained earnings | 13,592,891 | 12,614,979 |
| Treasury stock, at cost | (1,042,135) | (1,042,135) |
| Total stockholders' equity | 19,893,078 | 18,915,166 |
| TOTAL | $ 23,118,965 | $ 22,759,864 |

See Management's Discussion and Analysis.

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

| | 2017 | 2016 |
|---|---|---|
| REVENUES: | | |
| Contract revenues | $ 9,096,203 | $ 9,482,331 |
| Total Revenues | 9,096,203 | 9,482,331 |
| OPERATING EXPENSES: | | |
| Contract | 6,749,454 | 6,614,155 |
| General and administrative | 1,075,987 | 1,092,790 |
| Total Operating Expenses | 7,825,441 | 7,706,945 |
| OPERATING INCOME | 1,270,762 | 1,775,386 |
| GAIN ON DISPOSAL OF ASSET | 0 | 0 |
| INTEREST EXPENSE | (12,865) | (17,457) |
| INTEREST INCOME | 1,467 | 1,431 |
| INCOME BEFORE INCOME TAXES | 1,259,364 | 1,759,360 |
| PROVISION FOR INCOME TAXES | (532,100) | (743,200) |
| NET INCOME | $ 727,264 | $ 1,016,160 |
| BASIC EARNINGS PER SHARE | $ 0.81 | $ 1.14 |
| DILUTED EARNINGS PER SHARE | $ 0.81 | $ 1.14 |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR BASIC EARNINGS PER SHARE | 893,976 | 893,416 |
| EFFECT OF DILUTIVE SECURITIES – OPTIONS | 0 | 0 |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR DILUTED EARNINGS PER SHARE | 893,976 | 893,416 |

See Management’s Discussion and Analysis.

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

| | 2017 | 2016 |
|---|---|---|
| REVENUES: | | |
| Contract revenues | $17,800,956 | $18,648,523 |
| Total Revenues | 17,800,956 | 18,648,523 |
| OPERATING EXPENSES: | | |
| Contract | 13,003,287 | 12,948,676 |
| General and administrative | 2,153,152 | 2,177,221 |
| Total Operating Expenses | 15,156,439 | 15,125,897 |
| OPERATING INCOME | 2,644,517 | 3,522,626 |
| GAIN ON DISPOSAL OF ASSET | 2,000 | 2,000 |
| INTEREST EXPENSE | (26,862) | (37,476) |
| INTEREST INCOME | 2,007 | 2,599 |
| INCOME BEFORE INCOME TAXES | 2,621,662 | 3,489,749 |
| PROVISION FOR INCOME TAXES | (1,107,700) | (1,474,400) |
| NET INCOME | $ 1,513,962 | $ 2,015,349 |
| BASIC EARNINGS PER SHARE | $ 1.69 | $ 2.26 |
| DILUTED EARNINGS PER SHARE | $ 1.69 | $ 2.26 |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR BASIC EARNINGS PER SHARE | 893,694 | 893,416 |
| EFFECT OF DILUTIVE SECURITIES – OPTIONS | 0 | 0 |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR DILUTED EARNINGS PER SHARE | 893,694 | 893,416 |

See Management’s Discussion and Analysis.

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

| | 2017 | 2016 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Income | $1,513,962 | $2,015,349 |
| Adjustments to reconcile net income to net cash | | |
| provided by operating activities: | | |
| Depreciation and amortization | 355,210 | 313,432 |
| Gain on disposal of property and equipment | (2,000) | (2,000) |
| (Increase) decrease in | | |
| Accounts receivable | (500,750) | (980,834) |
| Prepaid expenses | (352,200) | (124,012) |
| Increase (decrease) in | | |
| Accounts payable | 63,875 | (35,065) |
| Accrued compensation and related liabilities | (574,205) | (392,714) |
| Accrued income taxes | 0 | (256,512) |
| Deferred rent | 106,599 | (12,118) |
| Deferred revenue | (58,355) | 375,124 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 552,136 | 900,650 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from sale of fixed assets | 2,000 | 2,000 |
| Change in cash surrender value of officer's life insurance | 0 | 155,575 |
| Purchases of property and equipment | (1,182,409) | (385,591) |
| NET CASH USED BY INVESTING ACTIVITIES | (1,180,409) | (228,016) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Dividend paid | (536,050) | (402,037) |
| Principal payments on note payable | (156,725) | (149,546) |
| NET CASH USED BY FINANCING ACTIVITIES | (692,775) | (551,583) |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (1,321,048) | 121,051 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 9,288,447 | 5,177,529 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $7,967,399 | $5,298,580 |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

| | 2017 | 2016 |
|---|---|---|
| Cash paid during the period for: | | |
| Interest | $ 26,862 | $ 37,476 |
| Income Taxes | $1,265,000 | $1,780,000 |

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.

Accounting Standards

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes,* which requires all deferred income tax assets and liabilities to be classified as noncurrent on the balance sheet. The new standard is effective for annual reporting periods beginning after December 15, 2016, with early adoption permitted. The Company has adopted this requirement retrospectively in the current period. The Company reclassified $112,400 of current deferred income tax assets and $36,200 of long term deferred income tax liabilities ($76,200, net) to other assets as of May 31, 2017.

Items of Note

In the second quarter of fiscal year 2018, which commenced on September 1, 2017, the Company realized net income of $727,264, a 28.4% decrease compared to net income of $1,016,160 for the second quarter of fiscal year 2017. Net income for the first six months of fiscal year 2018 totaled $1,513,962, a 24.9% decrease compared to the net income of $2,015,349 for the first six months of fiscal year 2017.

Based on fiscal year 2017 earnings, the Board of Directors declared a cash dividend of $.60 per share for shareholders of record on September 20, 2017. The dividend was paid on October 11, 2017. This amount is $.15 per share greater than the prior cash dividend of $.45 per share paid on October 26, 2016.

Subsequent to the end of the second quarter, the National Institute of Allergies and Infectious Diseases (NIAID) provided $2,400,000 of incremental funding for an existing task order under the contract entitled "Housing and Maintenance of Non-Human Primates for NIAID-VRC." The new funding covers costs incurred through September 27, 2019. The five-year contract (which expires on September 27, 2019) has a maximum potential funding amount of $43,077,850 including all options. The contract's current total funding is $19,854,988. There are, however, no assurances that the Company will be awarded any other task orders under this contract.

## Results of Operations

### Three Month Comparison

The $386,128 decrease in revenues to $9,096,203 for the quarter ended November 30, 2017, compared to $9,482,331 for the quarter ended November 30, 2016, is primarily the result of a decrease in commercial contract activity related to the completion of several studies performed for a pharmaceutical company during the current quarter compared to the second quarter of the previous fiscal year when the studies were in their initial stages and included revenues related to the purchase of the research animals utilized in the studies.

During the quarters ending May 31, 2016, August 31, 2016 and November 30, 2016, the Company experienced additional revenues related to the health industry’s efforts to find potential vaccines against the Zika virus. BIOQUAL was involved with research sponsored by both federal and commercial organizations that produced vaccine candidates that are now in clinical trials. Although the Company is still involved in on-going research related to the Zika virus, the amount of revenues generated by this research decreased significantly during this quarter as well as in the quarters ending February 28, 2017, May 31, 2017 and August 31, 2017.

The $135,299 increase in contract operating expenses for the quarter ended November 30, 2017, primarily reflects increases to indirect labor, facility, maintenance and depreciation expenses of approximately $300,000. The increase was partially offset by fewer expenses incurred related to the purchase of nonhuman primates compared to similar costs incurred in the second quarter of the previous fiscal year.

The $504,624 decrease in operating income primarily reflects the decrease in revenues in commercial contracts, which typically generate a higher gross margin and the effect of the increase in the indirect costs listed above compared to the same quarter of the previous fiscal year.

### Six Month Comparison

The $847,567 decrease in revenues to $17,800,956 for the six months ended November 30, 2017, compared to $18,648,523 for the six months ended November 30, 2016, is primarily the result of decreases in contract activity in government (approximately $230,000) and commercial (approximately $590,000) contracts related to Zika virus research compared to the first six months of the previous fiscal year.

The $54,611 increase in contract operating expenses for the six months ended November 30, 2017, primarily reflects increases to indirect labor, facility, maintenance and depreciation expenses of approximately $600,000. The increase was mostly offset by fewer expenses incurred related to the purchase of nonhuman primates compared to similar costs incurred in the first six months of the previous fiscal year.

The $878,109 decrease in operating income primarily reflects the decrease in revenues in commercial contracts, mostly related to Zika virus research (as described in the three month comparison), which typically generate a higher gross margin, and the effect of the increase in the indirect costs listed above compared to the same six month period of the previous fiscal year.

Liquidity and Capital Resources

During the first six months of fiscal year 2018, the Company directed approximately $1,180,000 towards capital expenditures. These expenditures were necessary to provide additional equipment and nonhuman primate and rodent cages for research being performed in the Company's laboratories. The amount paid toward capital expenditures reflects the beginning of the nonhuman primate cage replacement program (described in the Company's report for the period ending May 31, 2017), initiated during the first quarter of fiscal year 2018. The Company has been able to continue to fund all of these expenditures through the use of available cash provided by profits.

During the next six months, the Company estimates the aggregate purchase price of equipment to upgrade older equipment, enhance its capabilities, add nonhuman primate and small animal caging, and to renovate animal housing space will total approximately $1,000,000.

The Company is obligated, as lessee, under non-cancelable operating leases covering its facilities and certain equipment at various dates through 2026. Rent expense for the first six months of fiscal year 2018 was approximately $1,662,000. As of August 31, 2017, the total of the future minimum rental payments is approximately $21,398,000.

Other than the items mentioned above, the Company does not anticipate substantial capital and other expenditures during fiscal year 2018. 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 $2,000,000 line of credit with M&T Bank available to help cover costs of its daily operations. The line of credit is due on demand and renewable annually. As of November 30, 2017, there was no balance due 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, 2017, was 4.50%. On November 30, 2017, the Company had a balance of cash and cash equivalents of $7,967,399. As part of the funding of the February 2014 acquisition of the Advanced Biosciences Laboratories, Inc. *in-vivo* animal model services-related business, the Company obtained a $1,500,000 note from M&T Bank. The term note is payable in 60 monthly payments ($28,087.40) with the final payment to be made on February 28, 2019. 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 and its capital needs through the end of fiscal year 2018.

The following provides additional information on select balance sheet items: 1) the $500,750 increase in accounts receivable reflects a slower than normal collection rate for monthly invoices offset by a decrease in unbilled accounts receivable reflecting amounts to be billed upon completion of contract milestones; 2) the $574,205 decrease in accrued compensation and related liabilities primarily reflects the payment of the accrued fiscal year 2017 bonuses during the first quarter of fiscal year 2018; and 3) the $352,200 increase in prepaid expenses reflects prepayment of annual liability and workers compensation insurance premiums, real estate taxes and a deposit for the purchase of nonhuman primates for future studies; Refer to the Statements of Consolidated Cash Flows on Page 5 for further detail related to the changes in cash and cash equivalents.

## Compensation

On October 11, 2017, the Board of Directors and Dr. Mark Lewis, Chairman of the Board and the Company's President and Chief Executive Officer entered into an agreement granting Dr. Lewis 1,000 restricted shares of the Company's common stock. Under the agreement, during the three-year period following the grant, the Company will maintain possession of the stock certificate, and Dr. Lewis is prohibited from selling, transferring, pledging, hypothecating, assigning or otherwise disposing of the shares. Additionally, if Dr. Lewis' employment with the Company is terminated during the three-year period, he will forfeit the shares and the shares shall be deemed canceled. On the date of grant, the value of the shares was $39,500.00.

## Forward Looking Information

Statements herein that are not descriptions of historical facts are forward-looking and subject to risks 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; the Company's ability to obtain new government or commercial contracts; continued demand for the use of animal models in scientific research; the Company's ability to perform under its contracts in accordance with the requirements of the contracts; the actual costs incurred in performing the Company's contracts and its ability to manage its costs, including its capital expenditures; 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.