

Unaudited Financial Statements and Management's Discussion & Analysis  
For the quarterly period ended February 28, 2018

BIOQUAL, INC.

Prepared by:

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BIOQUAL, INC.

INDEX

| <u>Financial Information</u> .....  | <u>Page</u> |
|---|-------------|
| Financial Statements.   |             |
| Unaudited Consolidated Balance Sheets, February 28, 2018<br>and May 31, 2017.....   | 2           |
| Unaudited Consolidated Statements of Operations for<br>the Three Months Ended February 28, 2018 and<br>February 28, 2017..... | 3           |
| Unaudited Consolidated Statements of Operations for<br>the Nine Months Ended February 28, 2018 and<br>February 28, 2017.....  | 4           |
| Unaudited Consolidated Statements of Cash Flows<br>for the Nine Months Ended February 28, 2018 and<br>February 28, 2017.....  | 5           |
| Management's Discussion and Analysis.....   | 6           |

## BIOQUAL, INC. AND SUBSIDIARY

## UNAUDITED CONSOLIDATED BALANCE SHEETS, FEBRUARY 28, 2018 AND MAY 31, 2017

| <u>ASSETS</u>  | <u>February 28, 2018</u>    | <u>May 31, 2017</u>         |
|--|-----------------------------|-----------------------------|
| <b>CURRENT ASSETS:</b>   |                             |                             |
| Cash and cash equivalents  | \$ 8,450,900                | \$ 9,288,447                |
| Accounts receivable:   |                             |                             |
| Trade  | 7,942,302                   | 6,498,760                   |
| Unbilled - current   | 1,301,512                   | 1,777,618                   |
| Prepaid expenses   | 337,731                     | 258,103                     |
| Income taxes receivable  | 31,133                      | 77,733                      |
| Total current assets   | <u>18,063,578</u>           | <u>17,900,661</u>           |
| <b>FIXED ASSETS:</b>   |                             |                             |
| Leasehold improvements   | 4,729,294                   | 4,516,584                   |
| Furniture, fixtures and equipment  | 9,947,052                   | 8,445,039                   |
| Total  | 14,676,346                  | 12,961,623                  |
| Less accumulated depreciation and amortization   | <u>(10,519,004)</u>         | <u>(10,013,672)</u>         |
| Fixed assets, net  | <u>4,157,342</u>            | <u>2,947,951</u>            |
| <b>OTHER ASSETS:</b>   |                             |                             |
| Other intangibles, net   | 29,024                      | 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   | <u>1,903,569</u>            | <u>1,911,252</u>            |
| <b>TOTAL</b>   | <u><b>\$ 24,124,489</b></u> | <u><b>\$ 22,759,864</b></u> |
| <b><u>LIABILITIES</u></b>  |                             |                             |
| <b>CURRENT LIABILITIES:</b>  |                             |                             |
| Note payable, current portion  | 300,524                     | 317,214                     |
| Accounts payable   | 1,176,727                   | 1,241,025                   |
| Accrued compensation and related liabilities   | 1,041,794                   | 1,332,178                   |
| Deferred revenue   | 228,666                     | 209,193                     |
| Total current liabilities  | <u>2,747,711</u>            | <u>3,099,610</u>            |
| Note payable, net of current portion   | 30,265                      | 250,115                     |
| Deferred rent  | 649,315                     | 494,973                     |
| Total liabilities  | <u>3,427,291</u>            | <u>3,844,698</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; 1,599,408 shares issued; 894,416 and 893,416 shares outstanding | 15,994                      | 15,994                      |
| Additional paid-in capital   | 7,331,430                   | 7,326,328                   |
| Retained earnings  | 14,391,909                  | 12,614,979                  |
| Treasury stock, at cost  | <u>(1,042,135)</u>          | <u>(1,042,135)</u>          |
| Total stockholders' equity   | <u>20,697,198</u>           | <u>18,915,166</u>           |
| <b>TOTAL</b>   | <u><b>\$ 24,124,489</b></u> | <u><b>\$ 22,759,864</b></u> |

See Management's Discussion and Analysis.

BIOQUAL, INC. AND SUBSIDIARY  
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED FEBRUARY 28,

|  | <u>2018</u>       | <u>2017</u>       |
|--|-------------------|-------------------|
| REVENUES:  |                   |                   |
| Contract revenues  | \$ 8,331,395      | \$ 9,068,275      |
| Total Revenues   | <u>8,331,395</u>  | <u>9,068,275</u>  |
| OPERATING EXPENSES:  |                   |                   |
| Contract   | 6,077,635         | 6,448,254         |
| General and administrative   | <u>1,064,839</u>  | <u>1,147,529</u>  |
| Total Operating Expenses   | <u>7,142,474</u>  | <u>7,595,783</u>  |
| OPERATING INCOME   | 1,188,921         | 1,472,492         |
| GAIN ON DISPOSAL OF ASSET  | 14,000            | 1,700             |
| INTEREST EXPENSE   | (11,748)          | (15,942)          |
| INTEREST INCOME  | <u>11,745</u>     | <u>1,236</u>      |
| INCOME BEFORE INCOME TAXES   | 1,202,918         | 1,459,486         |
| PROVISION FOR INCOME TAXES   | <u>(403,900)</u>  | <u>(616,700)</u>  |
| NET INCOME   | <u>\$ 799,018</u> | <u>\$ 842,786</u> |
| BASIC EARNINGS PER SHARE   | <u>\$ 0.89</u>    | <u>\$ 0.94</u>    |
| DILUTED EARNINGS PER SHARE   | <u>\$ 0.89</u>    | <u>\$ 0.94</u>    |
| WEIGHTED AVERAGE NUMBER OF SHARES<br>OUTSTANDING FOR BASIC EARNINGS<br>PER SHARE   | 894,416           | 893,416           |
| EFFECT OF DILUTIVE SECURITIES -<br>OPTIONS   | <u>0</u>          | <u>0</u>          |
| WEIGHTED AVERAGE NUMBER OF SHARES<br>OUTSTANDING FOR DILUTED EARNINGS<br>PER SHARE | <u>894,416</u>    | <u>893,416</u>    |

See Management's Discussion and Analysis.

BIOQUAL, INC. AND SUBSIDIARY  
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE NINE MONTHS ENDED FEBRUARY 28,

|  | <u>2018</u>         | <u>2017</u>         |
|--|---------------------|---------------------|
| REVENUES:  |                     |                     |
| Contract revenues  | <u>\$26,132,351</u> | <u>\$27,716,798</u> |
| Total Revenues   | <u>26,132,351</u>   | <u>27,716,798</u>   |
| OPERATING EXPENSES:  |                     |                     |
| Contract   | 19,080,922          | 19,396,930          |
| General and administrative   | <u>3,217,991</u>    | <u>3,324,750</u>    |
| Total Operating Expenses   | <u>22,298,913</u>   | <u>22,721,680</u>   |
| OPERATING INCOME   | 3,833,438           | 4,995,118           |
| GAIN ON DISPOSAL OF ASSET  | 16,000              | 3,700               |
| INTEREST EXPENSE   | (38,610)            | (53,418)            |
| INTEREST INCOME  | <u>13,752</u>       | <u>3,835</u>        |
| INCOME BEFORE INCOME TAXES   | 3,824,580           | 4,949,235           |
| PROVISION FOR INCOME TAXES   | <u>(1,511,600)</u>  | <u>(2,091,100)</u>  |
| NET INCOME   | <u>\$ 2,312,980</u> | <u>\$ 2,858,135</u> |
| BASIC EARNINGS PER SHARE   | <u>\$ 2.59</u>      | <u>\$ 3.20</u>      |
| DILUTED EARNINGS PER SHARE   | <u>\$ 2.59</u>      | <u>\$ 3.20</u>      |
| WEIGHTED AVERAGE NUMBER OF SHARES<br>OUTSTANDING FOR BASIC EARNINGS<br>PER SHARE   | 893,932             | 893,416             |
| EFFECT OF DILUTIVE SECURITIES -<br>OPTIONS   | <u>0</u>            | <u>0</u>            |
| WEIGHTED AVERAGE NUMBER OF SHARES<br>OUTSTANDING FOR DILUTED EARNINGS<br>PER SHARE | <u>893,932</u>      | <u>893,416</u>      |

See Management's Discussion and Analysis.

BIOQUAL, INC. AND SUBSIDIARY  
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE NINE MONTHS ENDED FEBRUARY 28,

|   | <u>2018</u>        | <u>2017</u>        |
|---|--------------------|--------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES:   |                    |                    |
| Net Income  | \$2,312,980        | \$2,858,135        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                    |                    |
| Depreciation and amortization   | 545,015            | 468,310            |
| Share based compensation  | 5,102              | 0                  |
| Gain on disposal of property and equipment  | (16,000)           | (3,700)            |
| (Increase) decrease in  |                    |                    |
| Accounts receivable   | (967,436)          | (185,027)          |
| Prepaid expenses  | (33,028)           | (187,601)          |
| Increase (decrease) in  |                    |                    |
| Accounts payable  | (64,298)           | (42,124)           |
| Accrued compensation and related liabilities                                      | (290,384)          | (246,823)          |
| Accrued income taxes  | 0                  | (256,512)          |
| Deferred rent   | 154,342            | 57,531             |
| Deferred revenue  | <u>19,473</u>      | <u>(80,368)</u>    |
| NET CASH PROVIDED BY OPERATING ACTIVITIES   | <u>1,665,766</u>   | <u>2,381,821</u>   |
| CASH FLOWS FROM INVESTING ACTIVITIES:   |                    |                    |
| Proceeds from sale of fixed assets  | 16,000             | 3,700              |
| Change in cash surrender value of officer's life insurance                        | 0                  | 218,770            |
| Purchases of property and equipment   | <u>(1,746,723)</u> | <u>(439,610)</u>   |
| NET CASH USED BY INVESTING ACTIVITIES   | <u>(1,730,723)</u> | <u>(217,140)</u>   |
| CASH FLOWS FROM FINANCING ACTIVITIES:   |                    |                    |
| Dividend paid   | (536,050)          | (402,037)          |
| Principal payments on note payable  | <u>(236,540)</u>   | <u>(225,769)</u>   |
| NET CASH USED BY FINANCING ACTIVITIES   | <u>(772,590)</u>   | <u>(627,806)</u>   |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS                              | (837,547)          | 1,536,875          |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD                                  | <u>9,288,447</u>   | <u>5,177,529</u>   |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD  | <u>\$8,450,900</u> | <u>\$6,714,404</u> |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the period for:

|              |                    |                    |
|--------------|--------------------|--------------------|
| Interest     | <u>\$ 38,610</u>   | <u>\$ 53,418</u>   |
| Income Taxes | <u>\$1,465,000</u> | <u>\$2,360,000</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.

### 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 third quarter of fiscal year 2018, which commenced on December 1, 2017, the Company realized net income of \$799,018, a 5.2% decrease compared to net income of \$842,786 for the third quarter of fiscal year 2017. Net income for the first nine months of fiscal year 2018 totaled \$2,312,980, a 19.1% decrease compared to the net income of \$2,858,135 for the first nine months of fiscal year 2017.

### Results of Operations

#### Three Month Comparison

The \$736,880 decrease in revenues to \$8,331,395 for the quarter ended February 28, 2018, compared to \$9,068,275 for the quarter ended February 28, 2017, is primarily the result of a decrease in government contract activity related to the completion of the National Institute of Allergies and Infectious Diseases (NIAID) Task Order entitled "Cotton Rat Model for the Evaluation of RSV Vaccines and Therapeutics" under Part A of Indefinite Delivery/Indefinite Quantity (IDIQ) master contract number HHSN272201000006I, entitled "Animal Models of Infectious Diseases" as well as a few other smaller federal purchase orders during the fourth quarter of fiscal year 2017 with no replacement task order or purchase orders in the third quarter of fiscal year 2018.

The \$370,619 decrease in contract operating expenses for the quarter ended February 28, 2018, primarily reflects decreases to subcontractor costs related to the completion of the NIAID Task Order mentioned above and a decrease in contract material and supplies. The decrease above was partially offset by increases to

indirect labor and depreciation expenses of approximately \$330,000.

The \$82,690 decrease in General and Administrative (G&A) expenses reflects the third quarter of fiscal year 2017 expenses related to the surrender of an executive life insurance policy compared to no similar expenses being incurred during the third quarter of fiscal year 2018 and decreases in labor costs compared to the same quarter in fiscal year 2017.

The \$283,571 decrease in operating income primarily reflects the decrease in revenues being greater than the decrease in operating expenses.

The provision for income taxes reflects the passage of the "Tax Cuts and Jobs Act" which reduced the federal corporate tax rate from 34% to 21% effective January 1, 2018. The three month provision was calculated by applying the old tax rate to the taxable income generated during December 2017 and the new tax rate to the taxable income generated from January 1, 2018, to February 28, 2018. The impact of the application of the new tax rate was a decrease in income tax expense of \$104,300.

#### Nine Month Comparison

The \$1,584,447 decrease in revenues to \$26,132,351 for the nine months ended February 28, 2018, compared to \$27,716,798 for the nine months ended February 28, 2017, is primarily the result of the completion of the NIAID Task Order entitled "Cotton Rat Model for the Evaluation of RSV Vaccines and Therapeutics" and smaller federal purchase orders during the fourth quarter of fiscal year 2017 with no replacement task order or purchase orders in fiscal year 2018 and decreases in contract activity in government (approximately \$308,000) and commercial (approximately \$590,000) contracts related to Zika virus research compared to the first nine months of the previous fiscal year.

The \$316,008 decrease in contract operating expenses for the nine months ended February 28, 2018, primarily reflects decreases to nonhuman primate purchases, subcontractor costs and contract materials and supplies of approximately \$1,400,000. The decrease was partially offset by increases in indirect labor, facility, maintenance and depreciation expenses of approximately \$1,000,000.

The \$106,759 decrease in G&A expenses reflects the third quarter of fiscal year 2017 expenses related to the surrender of an executive life insurance policy compared to no similar expenses being incurred during the first nine months of fiscal year 2018 and decreases in labor costs compared to the same period in fiscal year 2017.

The \$1,161,680 decrease in operating income primarily reflects the decrease in revenues in commercial contracts, mostly related to Zika virus research, which typically generate a higher gross margin, and the effect of the increase in the indirect costs listed above compared to the same nine-month period of the



previous fiscal year.

The provision for income taxes reflects the passage of the "Tax Cuts and Jobs Act" which reduced the federal corporate tax rate from 34% to 21% effective January 1, 2018. The nine month provision was calculated by applying the old tax rate to the taxable income generated from June 1, 2017, to December 31, 2017, and the new tax rate to the taxable income generated from January 1, 2018, to February 28, 2018. The impact of the application of the new tax rate was a decrease in income tax expense of \$104,300.

### Liquidity and Capital Resources

During the first nine months of fiscal year 2018, the Company directed approximately \$1,746,000 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 from operations.

During the next three 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 \$400,000.

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 nine months of fiscal year 2018 was approximately \$2,491,000. As of February 28, 2018, the total of the future minimum rental payments is approximately \$20,569,000.

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 February 28, 2018, 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 February 28, 2018, was 4.50%. On February 28, 2018, the Company had a balance of cash and cash equivalents of \$8,450,900. 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 \$967,436 increase in accounts receivable reflects a slower than normal collection rate for monthly invoices offset by a decrease in unbilled accounts receivable resulting from the achievement of contract milestones in certain contracts providing for payments to be based upon completion of contract milestones; 2) the \$290,384 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 \$79,628 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.

#### Subsequent Development

In April 2018, the Company subscribed to the OTC Disclosure and News Service and now discloses quarterly and annual financial and other corporate information to the OTC Pink Marketplace. The information disclosure meets the OTC requirements necessary to reclassify BIOQUAL's listing from the "No Information" category to the "Current Information" category. Although the Company will continue its historic practice of disclosing its financial results on its website, the information reported to the OTC will provide additional information required by the OTC. The annual subscription cost for this service is \$5,000.

#### 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.