Unaudited Financial Statements and Management's Discussion & Analysis

For the quarterly period ended November 30, 2018

BIOQUAL, INC.

Prepared by:

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Chief Financial Officer

BIOQUAL, INC.

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BIOQUAL, INC.
UNAUDITED BALANCE SHEETS, NOVEMBER 30, 2018 AND MAY 31, 2018

ASSETS	**November 30, 2018**	May 31, 2018
CURRENT ASSETS:		
Cash and cash equivalents	**$ 8,378,041**	$ 10,160,610
Accounts receivable:		
Trade	**8,233,605**	7,341,309
Unbilled – current	**1,936,319**	1,924,063
Prepaid expenses	**956,885**	400,026
Income taxes receivable	**414,425**	427,425
Total current assets	**19,919,275**	20,253,433
FIXED ASSETS:		
Leasehold improvements	**4,843,208**	4,832,367
Furniture, fixtures and equipment	**10,929,843**	10,137,723
Total	**15,773,051**	14,970,090
Less accumulated depreciation and amortization	**(11,120,202)**	(10,682,020)
Fixed assets, net	**4,652,849**	4,288,070
OTHER ASSETS:		
Other intangibles, net	**21,341**	26,463
Goodwill	**1,028,408**	1,028,408
Cash value of officers' life insurance policies	**708,491**	708,491
Total other assets	**1,758,240**	1,763,362
TOTAL	**$ 26,330,364**	$ 26,304,865
LIABILITIES		
CURRENT LIABILITIES:		
Note payable, current portion	**85,867**	250,115
Accounts payable	**1,016,973**	1,803,654
Accrued compensation and related liabilities	**825,031**	1,045,125
Deferred revenue	**620,600**	365,014
Total current liabilities	**2,548,471**	3,463,908
Deferred income taxes	**105,700**	105,700
Deferred rent	**747,483**	685,677
Total liabilities	**3,401,654**	4,255,285
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 $.01 per share; 5,000,000 shares authorized; 1,599,408 shares issued; 894,416 shares outstanding	**15,994**	15,994
Additional paid-in capital	**7,340,410**	7,333,827
Retained earnings	**16,613,546**	15,740,999
Treasury stock, at cost	**(1,041,240)**	(1,041,240)
Total stockholders' equity	**22,928,710**	22,049,580
TOTAL	**$ 26,330,364**	$ 26,304,865

See Management's Discussion and Analysis.

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

	2018	2017
REVENUES:		
Contract revenues	**$ 8,361,478**	$ 9,096,203
Total Revenues	**8,361,478**	9,096,203
OPERATING EXPENSES:		
Contract	**6,381,260**	6,749,454
General and administrative	**1,218,893**	1,075,987
Total Operating Expenses	**7,600,153**	7,825,441
OPERATING INCOME	**761,325**	1,270,762
GAIN ON DISPOSAL OF ASSET	**0**	0
INTEREST EXPENSE	**(8,517)**	(12,865)
INTEREST INCOME	**59,005**	1,467
INCOME BEFORE INCOME TAXES	**811,813**	1,259,364
PROVISION FOR INCOME TAXES	**(237,500)**	(532,100)
NET INCOME	**$ 574,313**	$ 727,264
BASIC EARNINGS PER SHARE	**$ 0.64**	$ 0.81
DILUTED EARNINGS PER SHARE	**$ 0.64**	$ 0.81
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR BASIC EARNINGS PER SHARE	**893,416**	893,976
EFFECT OF DILUTIVE SECURITIES – OPTIONS	**163**	0
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR DILUTED EARNINGS PER SHARE	**893,579**	893,976

See Management’s Discussion and Analysis.

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

	2018	2017
REVENUES:		
Contract revenues	**$18,014,347**	$17,800,956
Total Revenues	**18,014,347**	17,800,956
OPERATING EXPENSES:		
Contract	**14,027,200**	13,003,287
General and administrative	**2,357,077**	2,153,152
Total Operating Expenses	**16,384,277**	15,156,439
OPERATING INCOME	**1,630,070**	2,644,517
GAIN ON DISPOSAL OF ASSET	**0**	2,000
INTEREST EXPENSE	**(18,137)**	(26,862)
INTEREST INCOME	**87,053**	2,007
INCOME BEFORE INCOME TAXES	**1,698,986**	2,621,662
PROVISION FOR INCOME TAXES	**(497,000)**	(1,107,700)
NET INCOME	**$ 1,201,986**	$ 1,513,962
BASIC EARNINGS PER SHARE	**$ 1.35**	$ 1.69
DILUTED EARNINGS PER SHARE	**$ 1.35**	$ 1.69
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR BASIC EARNINGS PER SHARE	**893,416**	893,694
EFFECT OF DILUTIVE SECURITIES – OPTIONS	**163**	0
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR DILUTED EARNINGS PER SHARE	**893,579**	893,694

See Management's Discussion and Analysis.

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

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	**$ 1,201,986**	$1,513,962
Adjustments to reconcile net income to net cash		
(used) provided by operating activities:		
Depreciation and amortization	**438,182**	355,210
Gain on disposal of property and equipment	**0**	(2,000)
Stock compensation expense	**6,583**	0
(Increase) decrease in		
Accounts receivable	**(644,917)**	(500,750)
Prepaid expenses	**(215,055)**	(352,200)
Increase (decrease) in		
Accounts payable	**(786,681)**	63,875
Accrued compensation and related liabilities	**(220,094)**	(574,205)
Deferred rent	**61,806**	106,599
Deferred revenue	**(125,642)**	(58,355)
NET CASH (USED) PROVIDED BY OPERATING ACTIVITIES	**(283,832)**	552,136
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of fixed assets	**0**	2,000
Purchases of property and equipment	**(797,839)**	(1,182,409)
NET CASH USED BY INVESTING ACTIVITIES	**(797,839)**	(1,180,409)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividend paid	**(536,650)**	(536,050)
Principal payments on note payable	**(164,248)**	(156,725)
NET CASH USED BY FINANCING ACTIVITIES	**(700,898)**	(692,775)
NET DECREASE IN CASH AND CASH EQUIVALENTS	**(1,782,569)**	(1,321,048)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	**10,160,610**	9,288,447
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$8,378,041**	$7,967,399

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the period for:		
Interest	**$ 18,137**	$ 26,862
Income Taxes	**$ 505,000**	$1,265,000

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.

Newly adopted accounting pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606),* and related amendments, which superseded all prior revenue recognition methods and industry-specific guidance. The core principle of Topic 606 is that an entity should recognize revenue to depict the transfer of control for promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the revenue principles, an entity is required to identify the contract(s) with a customer, identify the performance obligations, determine the transaction price, allocate the transaction price to the performance obligations and recognize revenue when the performance obligation is satisfied (i.e., either over time or point in time). Topic 606 further requires that companies disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

Topic 606 provides companies an option of two transition methods, the full retrospective method, in which case the standard would be applied to each prior reporting period presented and the cumulative effect of applying the standard would be recognized at the earliest period shown, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. The ASU is effective for annual reporting periods beginning after December 15, 2017.

Effective June 1, 2018 (beginning of fiscal year 2019), the Company adopted the requirements of Topic 606 using the modified retrospective method. The guidance was not applied to contracts that were complete at May 31, 2018, and the comparative information for the prior fiscal year has not been retrospectively adjusted.

The adoption of Topic 606 did not have a material impact on the Company's financial statements. The Company recorded a $207,211 increase to its beginning retained earnings as the cumulative impact of adoption of the new revenue standard. The primary impact of the new standard was on certain fixed-price-milestone type contracts, on which the Company previously recognized revenue primarily using the latest milestone achieved and under Topic 606 are recognized using a different over-time output measure which was considered to more effectively measure the progress on uncompleted milestones. Additionally, certain fixed-price type contracts had previously recognized contract components on a separate basis and these components are now combined under Topic 606 into a single performance obligation, as they are not capable of being distinct under the new guidance. Furthermore, certain associated contract fulfillment costs are considered incremental and require capitalization and amortization over the expected customer life under Topic 606. The adoption of Topic 606 did not have a significant impact on the Company's revenue recognition policy for other types of contracts since revenues on the substantial majority of the Company's contracts continue to be recognized over time and use the same measure of progress that was applicable under prior standards. As a result of applying the modified retrospective method to adopt the new guidance, the following adjustments were made on the balance sheet as of June 1, 2018:

	As Reported May 31, 2018	Adjustments	Adjusted June 1, 2018
Assets:			
Accounts receivable - unbilled	$ 9,265,372	$ 259,635	$ 9,525,007
Prepaid expenses	400,036	328,804	728,840
Liabilities:			
Deferred revenue	$ 365,014	$ 381,228	$ 746,242
Stockholders' Equity:			
Retained earnings	$ 15,740,999	$ 207,211	$ 15,948,210

In adopting Topic 606, the Company elected to use certain practical expedients permitted by the standard including using the portfolio approach where contracts with similar characteristics were assessed collectively to evaluate risk over the impact of Topic 606. The Company also elected to adopt the right-to-invoice practical expedient on cost-reimbursable, time-and-materials, and fixed-price-per-unit contracts where the Company recognizes revenues as it is contractually able to invoice the customer based on the control transferred to the customer.

Items of Note

In the second quarter of fiscal year 2019, which commenced on September 1, 2018, the Company realized net income of $574,313, a 21.0% decrease compared to net income of $727,264 for the second quarter of fiscal year 2018. Net income for the first six months of fiscal year 2019 totaled $1,201,986, a 20.6% decrease compared to the net income of $1,513,962 for the first six months of fiscal year 2018. See Results of Operations below for more detail on the decrease in net income.

During the second quarter of fiscal year 2019, the National Institute of Allergy and Infectious Diseases (NIAID) provided $6,018,117 of incremental funding for existing task orders under the contract entitled “Housing and Maintenance of Non-Human Primates for NIAID-VRC.” The new funding covers costs incurred through September 27, 2019. Subsequent to the end of the quarter, the NIAID awarded a task order entitled “Housing and Conduct of Procedures for Ferret Immunogenicity BSL2 study” to the Company. The one-year task order totals $152,522. 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 $31,047,424. There are, however, no assurances that the Company will be awarded any other task orders under this contract. Of the remaining $12,030,426 of unobligated contract amount, the contract includes options totaling $6,981,607 related to Biosafety Level 2 research utilizing ferrets and Biosafety Level 3 research utilizing both ferrets and nonhuman primates neither of which is likely to be exercised during the remaining term of the contract.

During the second quarter of fiscal year 2019, the NIAID notified the Company of the award of Task Order “Ferret Models for the Evaluation Vaccines and Vaccination Strategies” under Part A of the Pre-Clinical Models of Infectious Diseases (PCMID) Master Contract. This is the third task order awarded under the PCMID Master Contract, and totals $2,392,250 including all options. The current funding under the task order is $858,192 to cover costs incurred through March 16, 2020. There are, however, no assurances that the Company will be awarded any other task orders under the PCMID Master Contract or that any options will be exercised.

Based on fiscal year 2018 earnings, the Board of Directors declared a cash dividend of $.60 per share for shareholders of record on September 19, 2018. The dividend was paid on October 10, 2018. This amount is the same amount per share as the preceding cash dividend paid on October 11, 2017.

Results of Operations

Three Months Comparison

The $734,725 decrease in revenues to $8,361,478 for the quarter ended November 30, 2018, compared to $9,096,203 for the quarter ended November 30, 2018, is primarily the result of decreases in contract activity in commercial contracts of approximately $800,000 resulting from a decrease in the revenue generated by the purchase of nonhuman primates for new studies and federal grants of approximately $150,000 compared to the second quarter of the previous fiscal year. The decrease in revenues was partially offset by an increase in revenue generated by government contracts of approximately $175,000.

The $368,194 decrease in contract operating expenses for the quarter ended November 30, 2018, primarily reflects decreases in expenses incurred of approximately $585,000 related to subcontractors and the purchase of nonhuman primates. The decrease was partially offset by increases in depreciation expense resulting from the increase in capital expenditures in the previous fiscal year and higher facility maintenance, temporary labor and materials and supplies costs of approximately $200,000 compared to costs incurred in the second quarter of the previous fiscal year.

The $142,906 increase in General and Administrative (G&A) expenses for the quarter ended November 30, 2018, primarily reflects increases in consulting costs related to the implementation of and staff training of a new accounting system, implementation of revenue recognition procedures related to Topic 606 and updating the Company's IT infrastructure. The increase was also affected by the monthly subscription costs related to the new accounting system.

The $509,437 decrease in operating income primarily reflects the larger decrease in revenues than contract expenses and the increase in G&A expenses described above. Additionally, the fee percentage applied to subcontractor costs incurred on government contracts results in the generation of less revenue than fee percentages applied to costs on commercial contracts.

Six Months Comparison

The $213,391 increase in revenues to $18,014,347 for the six months ended November 30, 2018, compared to $17,800,956 for the six months ended November 30, 2018, is primarily the result of increased activity in government contracts of approximately $675,000 compared to the first six months of the previous fiscal year. The increase in from government contracts revenues was partially offset by decreases in revenue generated from the commercial sector of approximately

$125,000 and federal grants of approximately $300,000.

The $1,023,913 increase in contract operating expenses for the six months ended November 30, 2018, primarily reflects increases in expenses incurred of approximately $650,000 related to subcontractors, the purchase of nonhuman primates, an increase in depreciation expense (resulting from the increase in capital expenditures in the previous fiscal year), facility maintenance, temporary labor and materials and supplies. Additionally, labor costs increased approximately $365,000 (a third of which is indirect labor) compared to similar costs incurred in the first six months of the previous fiscal year. The increase in labor is a result of hiring additional staff to manage increasingly complex operational and regulatory issues involved in conducting services for our clients.

The $203,925 increase in General and Administrative (G&A) expenses for the six months ended November 30, 2018, primarily reflects increases in consulting costs related to the implementation of and staff training of a new accounting system, implementation of revenue recognition procedures related to Topic 606 and updating the Company's IT infrastructure. The increase was also impacted by the monthly subscription costs related to the new accounting system.

The $1,014,447 decrease in operating income primarily reflects the larger decrease in revenues than contract expenses and the increase in G&A expenses described above. Additionally, the fee percentage applied to subcontractor costs incurred on government contracts results in the generation of less revenue than fee percentages applied to costs on commercial contracts.

Liquidity and Capital Resources

During the first six months of fiscal year 2019, the Company directed approximately $800,000 towards capital expenditures compared to approximately $1,180,000 in the first six months of fiscal year 2018. These expenditures were necessary to provide additional equipment and nonhuman primate (NHP) and rodent cages for research being performed in the Company's laboratories. 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 to renovate animal housing space for current facilities will total approximately $800,000.

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 2019 was approximately $828,000. As of November 30, 2018, the total of the future minimum rental payments is approximately $18,184,000.

Subsequent to the end of the 2^{nd} quarter of fiscal year 2019, the Company entered into a lease for additional space to provide for potential growth in both *in-vivo* and *in-vitro* services. The terms for the building lease are annual rent of approximately $455,000 (with a 3% annual escalation) for 8 years. The Company will off-set the increase in annual rent over the next 2 years by being released early from an existing lease which carries an annual rent expense of approximately $253,000. The estimated total net increase in future minimum rental payments is approximately $4,340,000 through 2026. The Company is analyzing the potential need for additional equipment and small animal caging appropriate to utilize its expanded space. The result of this analysis may significantly increase the amount of capital expenditures over the next six to twelve months.

Other than the items mentioned above, the Company does not anticipate other substantial capital and other expenditures during fiscal year 2019. 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 those purchases.

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, 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 November 30, 2018, was 5.50%. On November 30, 2018, the Company had a balance of cash and cash equivalents of $8,378,041. 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 of $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 2019.

The following provides additional information on select balance sheet items: 1) the $904,552 increase in accounts receivable reflects a slower than normal collection rate during the first six months of fiscal year 2019 compared to the end of the previous fiscal year; 2) the $220,094 decrease in accrued compensation and related liabilities primarily reflects the payment of the accrued fiscal year 2018 bonuses during the first quarter of fiscal year 2019; 3) the $543,859 increase in prepaid expenses reflects prepayment of annual liability and workers compensation insurance premiums, real estate taxes and deposits for the purchase of nonhuman primates for future studies and new equipment as well as an increase in prepaid expenses related to the adoption of Topic 606; 4) the $786,681 decrease in accounts payable reflects less outstanding payments for subcontractors and animal purchases compared to the end of the previous fiscal year and 5) the $255,586 increase to deferred revenue primarily reflects increases due to the adoption of Topic 606 offset by meeting certain milestones for which advance payments had previously been received on certain commercial contracts. Refer to the Statements of Consolidated Cash Flows on Page 5 for further detail related to the changes in cash and cash equivalents.

Revenue recognition accounting policy

The Company has modified certain of its accounting policies to comply with the newly imposed requirements of Topic 606 referred to above. The revised policies are as follows.

Revenue Recognition: The Company's revenues from contracts with customers are for support provided to the National Institutes of Health (NIH) for research services for certain diseases and medical research areas, including cancer, AIDS, hepatitis, influenza, immunology, transgenics, contraception, neurobiology and behavior. The Company’s contracts are either directly with NIH or with entities providing research services for NIH.

The Company performs under various types of contracts, which include cost-reimbursable or cost-plus-fixed-fee (CPFF), time-and-materials (T&M), fixed-price-per-unit (FP-U), and fixed-price-milestone (FP-M) contracts.

To determine the proper revenue recognition, the Company first evaluates whether it has a duly approved and enforceable contract with a customer, in which the rights of the parties and payment terms are identified, and collectability is probable. The Company also evaluates whether two or more contracts should be combined and accounted for as a single contract, including the purchase or work orders issued under a Master Services Agreement (MSA) or similar arrangements. In addition, the Company assesses contract modifications to determine whether the changes to existing contracts should be accounted for as part of the original contract or as a separate contract. Contract modifications for the Company generally relate to changes in contract scope and related requirements, more specifically, additional testing, studies, or similar analysis that do not add distinct services, and therefore are accounted for as part of the original contract. If contract modifications add distinct goods or services, such as additional studies that are distinct from the original or previous study(ies), and increase the contract value by the standalone selling price, those modifications are accounted for as separate contracts.

Most of the Company's contracts comprise multiple promises which can include the procurement of the appropriate animal models if not already provided by the customer or by the Company, provisions for the care and housing of the animals, and services provided for the testing, studies, and/or analysis. In all cases, the Company assesses if the multiple promises should be accounted for as separate performance obligations or combined into a single performance obligation. The Company generally separates multiple promises in a contract as separate performance obligations if those promises are distinct, both individually and in the context of the contract. If multiple promises in a contract are highly interrelated or comprise a series of distinct services performed over time, they are combined and accounted for as a single performance obligation. A single performance obligation most frequently is the result, animal model studies, in which the customer at the outset of the original contract required that the models be euthanized at the completion of the study because it was determined that there was no distinct value within the context of the contract for the models, including their care and housing, apart from the studies and testing services. The FP-M type contracts primarily encounter this directive and as a result, often are treated as having a single performance obligation.

The Company's contracts often contain options to extend a study, perform a follow-on study, or perform a new study which is separate and distinct from the original or previous study(ies). The options generally result in modifications to the contract and therefore, the policies governing the accounting for modifications will apply. Since the options will generally contain the same terms and conditions, including pricing terms, such options typically do not provide the customer with any material additional rights under the contract.

Contracts with the U.S. Federal government are subject to the Federal Acquisition Regulations (FAR), and priced based on estimated or actual costs of providing the goods or services. The FAR provides guidance on types of costs that are allowable in establishing prices for goods and services provided to the U.S. government and its agencies. Each Federal contract is competitively priced and bid separately. Pricing for non-U.S. government agencies and commercial customers is based on specific negotiations with each customer. The Company excludes any taxes collected or imposed when determining the transaction price.

The transaction prices associated with the Company's CPFF and T&M contracts are variable. These variable amounts are estimated at the most likely amount that the Company expects to be entitled to based largely on an assessment of the Company’s anticipated performance and all information (historical, current, and forecasted) that is reasonably available and the potential of significant reversal of revenue.

The Company allocates the transaction price of a contract to its performance obligations in the proportion of its respective standalone selling prices. The standalone selling price of the Company's performance obligations is generally based on an expected cost-plus margin approach with relatively consistent margins applied within each major customer group. Very few, if any, of the Company's contracts contain a significant financing component, which would require an adjustment to the transaction price of the contract.

The Company recognizes revenue on a majority of the performance obligations within each contract over time as there is continuous transfer of control to the customer over the duration of the contract as the Company performs the promised services. For U.S. Federal government contracts, continuous transfer of control to the customer is evidenced by clauses in the contract that allow the customer to unilaterally terminate the contract for convenience, pay for costs incurred plus a reasonable profit and take control of any work-in-process. Similarly, for non-U.S. government contracts, the customer typically controls the work-in-process as evidenced by rights to payment for work performed to date plus a reasonable profit to deliver products or services that do not have an alternate use to the Company. In certain cases, when no euthanasia is directed by the customer at the outset of the contract, the animals may be re-purposed for a new or different and distinct study. In these cases, the re-purposing is generally not known until the end or close to the end of the original or previous study; however, this would indicate that the animals could potentially have an alternative use. Therefore, where there is a separate performance obligation associated with the procurement of the animals, the Company recognizes revenue at a point in time using a rate per unit as the animals are procured and the customer obtains control.

On FP-M contracts, for the performance obligation(s) where revenue is recognized over time, the Company generally uses a method that measures the extent of progress towards completion of a performance obligation, principally using an output method. Under the output method, revenue is recognized based on the best measure of progress relevant to the performance obligation and services provided. The output measure primarily used is a method in which revenue is recognized based upon the proportion of total study-related procedures and/or tests performed to date to estimated total procedures and/or tests through completion of the study. This ratio is computed using the value associated with each procedure and/or test performed because certain procedures could be considered more valuable than others. Additionally, on certain FP-M contracts where the care and housing of the animals is considered a separate performance obligation, revenue is recognized over time using a straight-line method since control of the services is provided to the customer relatively evenly over the period of performance. On certain other contracts, principally T&M, FP-U, and CPFF, revenue is recognized using the right-to-invoice practical expedient as the Company is contractually able to invoice the customer based on the control transferred to the customer.

Contract costs generally include direct costs such as those associated with procuring the animal models, materials, labor, subcontract costs, costs for housing and care of the animals, and indirect costs identifiable with or allocable to a specific contract. Costs are expensed as incurred, except for costs associated with procuring the models for contracts where they are directed to be euthanized by the customer. Such costs are capitalized and amortized on a straight-line basis over the expected life of that contract. The Company does not incur significant incremental costs to acquire contracts.

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 November 30, 2018, the Company had negotiated final settlements on indirect cost rates through 2011. 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.

Changes in estimates related to contracts with performance obligation(s) accounted for using the output method on FP-M type contracts, that are primarily based on a proportion of study-related procedures and/or tests, are recognized in the period in which such changes are made on a cumulative catch-up basis. This basis recognizes in the current period the cumulative effect of the changes on current and prior periods based on the performance obligations' related proportionate progress towards completion.

For the six months ended November 30, 2018, there were no material modifications recorded related to work previously performed on contracts prior to the execution of formal modifications or amendments. A significant change in one or more estimates could affect the profitability of one or more of the performance obligations.

Revenue From Contracts With Customers

Dual Reporting: The effects to the financial statements as of and for the three and six months ended November 30, 2018, as a result of applying Topic 606, rather than previous GAAP (ASC 605), are as follows:

	As Reported (Topic 606)	As Adjusted (ASC 605)
Assets:		
Accounts receivable - Unbilled	$ 1,936,319	$ 2,278,224
Prepaid expenses	956,885	630,354
Liabilities:		
Deferred revenue	$ 620,600	$ 559,370
Stockholders' Equity:		
Retained earnings	$ 16,613,546	$ 16,607,149

	Three months Ended November 30, 2018		Six months Ended November 30, 2018	
	As Reported (Topic 606)	As Adjusted (ASC 605)	As Reported (Topic 606)	As Adjusted (ASC 605)
Contract revenue	$ 8,361,478	$ 8,348,025	$ 18,014,347	$ 18,259,889
Contract expenses	6,381,260	6,487,948	14,027,200	14,024,927
Operating income	761,325	641,184	1,630,070	1,913,885
Income before income taxes	811,813	691,672	1,698,986	1,982,801
Provision for income taxes	237,500	202,300	497,000	580,000
Net income	574,313	489,372	1,201,986	1,402,801
Basic earnings per share	$ 0.64	$ 0.55	$ 1.35	$ 1.57
Diluted earnings per share	$ 0.64	$ 0.55	$ 1.35	$ 1.57

The changes reflected above were primarily due to certain fixed-price-milestone type contracts, on which the Company previously recognized revenue using the latest milestone achieved and under Topic 606 are recognized using a different over-time output measure which was considered to more effectively measure the progress on uncompleted milestones. Additionally, certain fixed-price type contracts had previously recognized contract components on a separate basis and these components are now combined under Topic 606 into a single performance obligation, as they are not capable of being distinct under the new guidance. Furthermore, certain associated contract fulfillment costs are considered incremental and require capitalization and amortization over the expected customer life under Topic 606.

Remaining Performance Obligations: Remaining performance obligations represent the expected value (transaction price) of executed contracts, both funded and unfunded, less revenue recognized to date. Remaining performance obligations do not include future potential purchase or work orders expected to be awarded under MSA or similar agreements.

As of November 30, 2018, the Company expects to recognize a majority of the remaining performance obligations over the next 12 months.

Disaggregation of Revenues: The Company disaggregates revenue by customer-type and contract-type, as these categories best represent how the nature, timing and uncertainty of the Company’s revenue and cash flows are affected by the U.S. government procurement environment and economic factors.

Disaggregated revenue by customer-type and contract type was as follows:

Revene by Customer Type and Contract Type	**Three Months Ended November 30, 2018**	**Six Months Ended November 30, 2018**
National Institutes of Health (NIH)		
Cost-Plus-Fixed-Fee	$ 1,012,269	$ 2,182,196
Fixed-Price-Per-Unit and Time-And-Materials	1,950,942	3,756,741
Fixed-Price-Milestone	83,113	180,740
Total National Institutes of Health	3,046,324	6,119,677
Commercial and Other		
Fixed-Price-Per-Unit and Time-And-Materials	3,549,329	7,699,945
Fixed-Price-Milestone	1,765,825	4,194,725
Total Commercial and Other	5,315,154	11,894,670
Total Revenues	$ 8,361,478	$ 18,014,347

CPFF contracts are generally lower risk and have lower profits. T&M and FP-U contracts are also low risk but profits may vary depending on actual labor costs compared to negotiated contract billing rates. FP-M contracts offer the potential for higher profits while increasing the Company's exposure to risk of cost overruns.

Contract Assets and Liabilities: Contract assets include unbilled contract receivables, which is the amount of revenue recognized that exceeds the amount billed to the customer, and right to payment is not just subject to the passage of time. Contract assets also include incremental fulfillment costs where, under certain FP contracts, costs are incurred usually at the beginning of the contract performance, where the single performance obligation has not yet been completely satisfied. Contract liabilities consist of deferred revenue.

The components of contract assets and contract liabilities consisted of the following:

		November 30, 2018	**June 1, 2018 (1)**
Contract assets:	Balance sheet line item:		
Unbilled contract receivables (2)	Accounts receivable - contracts	$ 1,936,319	$ 2,183,698
Fulfillment costs	Prepaid expenses	326,530	328,804
		$ 2,262,849	$ 2,512,502
Contract liabilities:	Balance sheet line item:		
Deferred revenue	Deferred revenue	620,600	$ 746,242

The increase in "Contract assets" was primarily due to the timing of billings and revenue recognized on certain contracts. The increase also relates to fulfillment costs being capitalized on certain contracts, offset by amortization for the six months ended November 30, 2018. The increase in "Contract liabilities- current" was primarily due to billings in excess of revenue recognized on certain FP-M contracts.

During the six months ended November 30, 2018, the Company recognized revenue of approximately $367,000 relating to amounts that were included as a contract liability at June 1, 2018.

During the six months ended November 30, 2018, the Company recognized approximately $232,000 of amortization related to its fulfillment costs. The Company did not recognize any impairment losses on contract assets for the six months ended November 30, 2018.

(1) Includes the cumulative effect of the changes made to the Company's opening balance sheet at June 1, 2018, as a result of the adoption of ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*.

(2) Balances include primarily timing differences between what the Company has billed or has the right to bill as of the period end as compared with the revenue recognized, on FP-M and CPFF type contracts.

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.