Management's Discussion & Analysis

For the year ended May 31, 2016

BIOQUAL, INC.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Highlights

In fiscal year 2016, which ended on May 31, 2016, the Company realized a net income $2,878,367 compared to net income of $1,906,428 for fiscal year 2015, for reasons discussed in the results of operations section below.

On August 30, 2015, the Company was awarded its 7th task order under Part A of National Institute of Allergies and Infectious Diseases (NIAID) contract number HHSN272201000006I, entitled "Animal Models of Infectious Diseases," (the "AMID Master Contract"). The 3-year task order entitled "Cotton Rat Model for the Evaluation of RSV Vaccines and Therapeutics" totals $2,120,483 including all options. The current funding is $1,292,616 to cover costs incurred through November 13, 2017. There are, however, no assurances that the NIAID will exercise options for additional work under the task order, or that Company will be awarded any other task orders under this contract.

On September 2, 2015, the Company was notified of the award of its 8th task order under Part C of the AMID Master Contract. The 3 1/2 year task order, entitled "Model Refinement in Pig-Tailed Macaques: Assessments of Chlamydia tracomatis (CT) Infection with Clinical or Laboratory Strains of the Genital Serovars for Product Testing in the Model" totals $5,834,974, including all options. The current funding is $1,358,297 to cover costs incurred through October 31, 2016. There are, however, no assurances that the NIAID will exercise options for additional work under the task order, or that Company will be awarded any other task orders under this contract.

On September 17, 2015, the Company was notified of the termination by NIAID of Part B of the AMID Master Contract. As is the case for most of the Company's government contracts, this was an indefinite quantity contract awarded to a number of contractors; specific projects were subsequently to have been the subject of competitively proposed task orders, with no assurance that task orders would be awarded to every contractor, but with the assurance of a guaranteed minimum payment of $100,000. The Company had not been awarded any task orders under Part B of this contract, although the Company has been awarded task orders under Part A and, as noted above, Part C of the AMID Master Contract. NIAID determined that no additional task orders would be required for the remainder of the contract term, so the continuation of Part B no longer fulfilled an existing government need. The Company received the guaranteed minimum payment of $100,000 during the second quarter of fiscal year 2016.

During the second quarter of fiscal year 2016, the NIAID exercised the remaining options of the task order entitled "Filovirus (FiloV) Vaccination Studies in non-human primates (NHP)" issued under Part C of the AMID Master Contract. The exercised options total $792,897, increasing the funding for the task order to its full amount of $2,029,889. The funding covers costs incurred through December 4, 2016. There are, however, no assurances that the Company will be awarded any other task orders under this contract.

During fiscal year 2016, the NIAID awarded new task orders and exercised options under the contract entitled "Housing and Maintenance of Non-Human Primates for NIAID-VRC" totaling $6,499,515. The additional awards increased the allowable number of animals utilized under the contract from 300 to 529. Although funding was provided to cover increasing the number of animals being studied to 529, the actual average number of animals increased from 300 to 400 during the fiscal year. The new funding is to cover costs incurred through May 8, 2017. 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 $12,234,871. There are, however, no assurances that the Company will be awarded any other task orders under this contract.

During April, 2016, the Company was awarded its 10th, 11th and 12th task orders under the NIAID contract entitled "Simian Vaccine Evaluation Unit". The 10th task order, which is a fully funded 27 month task order entitled "Immunogenicity and Efficacy of (A) rVSV-HIVenv Prime, HIV Envelope Protein Boost Vaccination Regimen and (B) DNA-HIV Prime, rVSV-HIVenv Boost Vaccination Regimen in the Rhesus Macaque SHIV Mucosal Challenge Model" totals $1,624,996. The 11th task order, which is the fully funded 15 month task order entitled "Evaluation of the Immunogenicity and Efficacy of a Nonintegrating Integrase-Defective Lentiviral Vector (IDLV)" totals $157,372. The 12th task order, which is a 36 month task order entitled "Maintenance of Fifty (50) NHPs" totals $690,389 including all options. The current funding under the 12th task order is $223,386 to cover costs incurred from May 1, 2016 through April 30, 2017. There are, however, no assurances that the NIAID will exercise options for additional work under the 12th task order, or that the Company will be awarded any other task orders under this contract.

Based on fiscal year 2015 earnings, the Board of Directors declared a cash dividend of $.35 per share for shareholders of record on December 25, 2015. The dividend was paid on January 13, 2016. This amount is $.15 per share greater than the $.20 per share cash dividend paid on December 15, 2014.

Results of Operations

Results of Operations 2016 versus 2015

The $4,124,627 increase in revenues to $33,060,341 for fiscal year 2016, compared to $28,935,714 for fiscal year 2015, is primarily due to: (1) an increase in government contract revenues of approximately $2,500,000, resulting from revenues related to an increase of 100 animals being studied for the NIAID-VRC contract (mentioned above) and revenues for two other contracts which began in the second and third quarter, respectively, of fiscal year 2015; (2) the $100,000 minimum payment from the termination of part of one contract during the second quarter of fiscal year 2016; (3) the one-time collection of $109,000 related to prior fiscal year indirect rate variances for an expired contract; and (4) an increase of approximately $1,500,000 in commercial contract revenues, primarily reflecting an increase in contract activity with 2 major pharmaceutical companies during fiscal year 2016. The Company performed more than triple the number of studies (up from 5 in fiscal year 2015 to 16 in fiscal year 2016) for one of the companies and double the number of studies (12 in fiscal year 2015 and 25 in fiscal year 2016) for the other.

The $2,784,952 increase in contract operating expenses for fiscal year 2016 primarily reflects expenses incurred related to purchase of nonhuman primates required for new commercial contracts and subcontractor costs related to the increase in government task orders. The $136,734 decrease in General and Administrative (G&A) expenses primarily reflects a decrease in incentive compensation and a decrease in amortization expense related to intangible assets resulting from some of the intangible assets being fully amortized during fiscal year 2016. Those assets were created as a result of purchase of the animal model business in fiscal year 2014 from Advanced Bioscience Laboratories, Inc. ("ABL") pursuant to the Asset Purchase Agreement ("APA") with ABL described in the previous report for the period ending May 31, 2014.

Pursuant to the APA, the Company may be required to pay ABL contingent consideration up to a maximum of $4,000,000 in cash, based on calendar year 2014, 2015, and 2016 revenues generated by the acquired business. At May 31, 2016, Management analyzed the fair value of the contingent consideration relating to the ABL transaction. Based on the available relevant data, such as current ABL subcontract backlog and outstanding proposals submitted for potential ABL subcontracts, the Company has decreased the liability recorded for the contingent consideration by $265,400 from $328,900 to $63,500. This decrease of the estimated contingent consideration payable resulted in an increase in operating income of $265,400 and is reflected in the Consolidated Statements of Income as a decrease in G&A expenses.

The $1,476,409 increase in operating income is primarily due to the continuing shift in customer base from government contracts with attendant lower profit margins to contracts with commercial pharmaceutical and therapeutics companies for which the Company is able to negotiate higher profit margins. The increase in operating income also reflects the $265,400 decrease in the contingent consideration payable mentioned above, the $100,000 guaranteed minimum payment related to the termination of Part B of an NIAID Master Contract and the one-time collection of $109,000 related to prior fiscal year indirect rate variances for an expired contract as previously mentioned.

Liquidity and Capital Resources

During fiscal year 2016, the Company expended approximately $483,000 on capital expenditures. These expenditures were necessary to provide additional equipment 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 existing cash provided by profits and its line of credit.

During fiscal year 2017, the Company estimates the aggregate purchase price of equipment to upgrade older equipment or enhance its capabilities, to acquire an animal facility management software program, to renovate animal housing space, and to acquire nonhuman primate caging for the renovated space will be approximately $600,000.

As noted above, pursuant to the APA with ABL, the Company may pay ABL contingent consideration up to a maximum of $4,000,000 in cash, based on calendar year 2014, 2015, and 2016 revenues generated by the acquired business. The acquired business revenues for the pro-rated first year (2014) and second year (2015) of operations did not meet the necessary level to require a payment against the calendar years 2014 and 2015 contingent consideration as set in the APA. The maximum contingent consideration for calendar year 2016 is $1,622,000. The Company has assumed the lease for ABL's animal laboratories, acquired related assets, assumed certain contracts, and is performing additional animal model services as a subcontractor to ABL. The Company believes the combination of the working capital generated by its ongoing business and the acquired business, cash on hand, and the line of credit will provide sufficient capital resources to provide for any future supplemental payments to ABL, the purchase of any necessary equipment and continuing daily operations.

The Company is obligated, as lessee, under non-cancelable operating leases covering its facilities and certain equipment at various dates through 2026. The total rent expense for the years ended May 31, 2016 and 2015 was approximately $2,978,000 and $2,866,000 respectively. Refer to Note 7, Operating Leases, in the audited financial statements available on the Company's website at www.bioqual.com for further details related to future minimum rental payments.

Other than the items mentioned above, the Company does not anticipate other substantial capital and other expenditures during fiscal year 2017. 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 May 31, 2016, 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 May 31, 2016, was 3.75%. On May 31, 2016, the Company had a balance of cash and cash equivalents of $5,177,529. As part of the funding of the February 2014 acquisition of the ABL *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 2017.

Other balance sheet items worth noting are: 1) the $293,147 decrease in accrued compensation and related liabilities primarily reflects a smaller accrual of incentive bonuses earned as of May 31, 2016, compared to May 31, 2015; 2) the net $1,454,458 increase in accounts receivable primarily reflects an increase of approximately $2,954,900 in trade accounts receivable reflecting 4th quarter increased contract activity and a slower collection rate for a few clients (the increase being partially off-set by a $1,500,500 decrease in unbilled accounts receivable due to the invoicing in fiscal year 2016 of completed billing milestones for several studies included in unbilled receivables at May 31, 2015); 3) the $415,076 increase in accounts payable primarily reflects increases in subcontractor invoices related to two of the government task orders mentioned above compared to similar invoices outstanding as of May 31, 2015, and the overall increase in contract activity during the 4th quarter of fiscal year 2016; 4) the $438,207 decrease in income taxes receivable reflects the application of the estimated tax deposits from fiscal year 2015 against the fiscal year 2016 tax liability; and 5) the $190,943 decrease in deferred revenue reflects the revenue recognition on the completion of work for which advance payments had been received prior to the beginning of fiscal year 2016. Refer to the Statements of Consolidated Cash Flows on Pages

7 and 8 of the audited financial statements available on the Company’s website at www.bioqual.com for further details 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 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 commercial contracts; the performance of the business acquired in the ABL acquisition; the Company’s ability to perform under its contracts in accordance with the requirements of the contracts; the actual cost incurred in performing the Company’s contracts and its ability to manage its costs; 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.