Unaudited Financial Statements and Management's Discussion & Analysis

For the quarterly period ended November 30, 2019

BIOQUAL, INC.

Prepared by:

David Newcomer
Chief Financial Officer

BIOQUAL, INC.

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Financial Statements.

BIOQUAL, INC.
UNAUDITED BALANCE SHEETS, NOVEMBER 30, 2019 AND MAY 31, 2019

ASSETS	**November 30, 2019**	May 31, 2019
CURRENT ASSETS:		
Cash and cash equivalents	**$ 6,135,087**	$ 9,207,608
Accounts receivable:		
Trade	**15,694,142**	6,837,333
Unbilled – current	**1,961,813**	4,591,636
Prepaid expenses	**678,281**	534,104
Income taxes receivable	**224,800**	100,000
Total current assets	**24,694,123**	21,270,681
FIXED ASSETS:		
Leasehold improvements	**5,110,508**	4,970,031
Furniture, fixtures and equipment	**12,459,457**	11,823,373
Total	**17,569,965**	16,793,404
Less accumulated depreciation and amortization	**(11,943,014)**	(11,499,795)
Fixed assets, net	**5,626,951**	5,293,609
OTHER ASSETS:		
Other intangibles, net	**11,097**	16,219
Goodwill	**1,028,408**	1,028,408
Operating lease right-of-use assets	**15,757,729**	0
Cash value of officers' life insurance policies	**700,827**	700,827
Total other assets	**17,498,061**	1,745,454
TOTAL	**$ 47,819,135**	$ 28,309,744
LIABILITIES		
CURRENT LIABILITIES:		
Accounts payable	**1,265,198**	1,311,657
Accrued compensation and related liabilities	**868,392**	1,159,286
Operating lease liabilities, current	**2,582,788**	0
Deferred revenue	**2,573,453**	269,632
Total current liabilities	**7,289,831**	2,740,575
Deferred income taxes	**208,400**	208,400
Operating lease liabilities, non-current	**14,159,906**	0
Deferred rent	**0**	796,586
Total liabilities	**21,658,137**	3,745,561
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 $.01 per share; 5,000,000 shares authorized; 1,599,408 shares issued; 894,416 shares outstanding	**15,994**	15,994
Additional paid-in capital	**7,353,576**	7,346,994
Retained earnings	**19,832,668**	18,242,435
Treasury stock, at cost	**(1,041,240)**	(1,041,240)
Total stockholders' equity	**26,160,998**	24,564,183
TOTAL	**$ 47,819,135**	$ 28,309,744

See Management's Discussion and Analysis.

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

	2019	2018
REVENUES:		
Contract revenues	**$11,222,962**	$ 8,361,478
Total Revenues	**11,222,962**	8,361,478
OPERATING EXPENSES:		
Contract	**8,578,373**	6,381,260
General and administrative	**1,418,100**	1,218,893
Total Operating Expenses	**9,996,473**	7,600,153
OPERATING INCOME	**1,226,489**	761,325
INTEREST EXPENSE	**(4,147)**	(8,517)
INTEREST INCOME	**35,699**	59,005
INCOME BEFORE INCOME TAXES	**1,258,041**	811,813
PROVISION FOR INCOME TAXES	**(366,200)**	(237,500)
NET INCOME	**$ 891,841**	$ 574,313
BASIC EARNINGS PER SHARE	**$ 1.00**	$ 0.64
DILUTED EARNINGS PER SHARE	**$ 1.00**	$ 0.64
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR BASIC EARNINGS PER SHARE	**893,416**	893,416
EFFECT OF DILUTIVE SECURITIES – RESTRICTED SHARES	**422**	163
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR DILUTED EARNINGS PER SHARE	**893,838**	893,579

See Management’s Discussion and Analysis.

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

	2019	2018
REVENUES:		
Contract revenues	**$21,290,838**	$18,014,347
Total Revenues	**21,290,838**	18,014,347
OPERATING EXPENSES:		
Contract	**15,632,914**	14,027,200
General and administrative	**2,584,868**	2,357,077
Total Operating Expenses	**18,217,782**	16,384,277
OPERATING INCOME	**3,073,056**	1,630,070
INTEREST EXPENSE	**(10,451)**	(18,137)
INTEREST INCOME	**69,919**	87,053
INCOME BEFORE INCOME TAXES	**3,132,524**	1,698,986
PROVISION FOR INCOME TAXES	**(916,200)**	(497,000)
NET INCOME	**$ 2,216,324**	$ 1,201,986
BASIC EARNINGS PER SHARE	**$ 2.48**	$ 1.35
DILUTED EARNINGS PER SHARE	**$ 2.48**	$ 1.35
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR BASIC EARNINGS PER SHARE	**893,416**	893,416
EFFECT OF DILUTIVE SECURITIES – RESTRICTED SHARES	**422**	163
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR DILUTED EARNINGS PER SHARE	**893,838**	893,579

See Management's Discussion and Analysis.

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

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	**$ 2,216,324**	$1,201,986
Adjustments to reconcile net income to net cash		
used by operating activities:		
Depreciation and amortization	**448,341**	438,182
Amortization of operating lease right-of-use asset	**1,614,784**	0
Stock compensation expense	**6,583**	6,583
(Increase) decrease in		
Accounts receivable	**(6,226,986)**	(644,917)
Prepaid expenses	**(268,977)**	(215,055)
Increase (decrease) in		
Accounts payable	**(46,459)**	(786,681)
Accrued compensation and related liabilities	**(290,894)**	(220,094)
Operating lease liability	**(1,426,406)**	0
Deferred rent	**0**	61,806
Deferred revenue	**2,303,821**	(125,642)
NET CASH USED BY OPERATING ACTIVITIES	**(1,669,869)**	(283,832)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of fixed assets	**0**	0
Purchases of property and equipment	**(776,561)**	(797,839)
NET CASH USED BY INVESTING ACTIVITIES	**(776,561)**	(797,839)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividend paid	**(626,091)**	(536,650)
Principal payments on note payable	**0**	(164,248)
NET CASH USED BY FINANCING ACTIVITIES	**(626,091)**	(700,898)
NET DECREASE IN CASH AND CASH EQUIVALENTS	**(3,072,521)**	(1,782,569)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	**9,207,608**	10,160,610
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 6,135,087**	$ 8,378,041
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	**$ 10,451**	$ 18,137
Income Taxes	**$ 1,062,000**	$ 505,000
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Recognition of ROU asset	**$17,235,776**	$ 0
Recognition of operating lease liability	**$18,032,362**	$ 0
Derecognition of deferred rent liability	**$ 796,586**	$ 0

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

The Company adopted the provisions of ASU 2016-02, Leases ("Topic 842"), as amended, as of June 1, 2019. The adoption of Topic 842 had a material impact on the Company's Consolidated Balance Sheets due to the recognition of certain right-of-use ("ROU") assets and lease liabilities. See Notes to the financial statement - Leases for new disclosures and policy information related to the Company's leases. Because of the transition method we used to adopt Topic 842, Topic 842 will not be applied to periods prior to adoption and the adoption of Topic 842 had no impact on the Company's previously reported results, or on opening equity at June 1, 2019.

Items of Note

In the second quarter of fiscal year 2020, which commenced on September 1, 2019, the Company realized net income of $891,841, a 55.3% increase compared to net income of $574,313 for the second quarter of fiscal year 2019. Net income for the first six months of fiscal year 2020 totaled $2,216,324, an 84.4% increase compared to the net income of $1,201,986 for the first six months of fiscal year 2019. See Results of Operations below for more detail on the increase in net income.

During the second quarter of fiscal year 2020 the National Institute of Allergy and Infectious Diseases (NIAID) provided $756,039 of additional funding for the existing task order "Refinement of a Pig-Tail Macaque Model of Gonococcal Infection" under Part B of the Pre-Clinical Models of Infectious Diseases (PCMID) Master Contract. The additional funds increase the total amount of the task order from $1,705,236 to $2,461,275. The contract period of performance end date was extended from November 23, 2019 to March 31, 2020. There are, however, no assurances that the Company will be awarded any other task orders under the PCMID Master Contract.

Based on fiscal year 2019 earnings, the Board of Directors declared a cash dividend of $.70 per share for shareholders of record on September 25, 2019. The dividend was paid on October 16, 2019.

Results of Operations

Three Months Comparison

The $2,861,484 increase in revenues to $11,222,962 for the quarter ended November 30, 2019, compared to $8,361,478 for the quarter ended November 30, 2018, is primarily the result of an increase in contract activity in commercial contracts of approximately $3,230,000 compared to the second quarter of the previous fiscal year. The increase in revenues was partially offset by decreases in revenue generated by government contracts of approximately $340,000 and federal grants of approximately $28,000. The increase in commercial contract revenues is primarily the result of several new projects starting up for two large pharmaceutical company clients compared to similar projects starting up in the same quarter of fiscal year 2019.

The $2,197,113 increase in contract operating expenses for the quarter ended November 30, 2019, primarily reflects increases in expenses incurred of approximately $1,310,000 related to the purchase of nonhuman primates, higher labor and related benefits costs of approximately $300,000, higher contract materials and supplies costs of approximately $300,000 compared to similar costs incurred in the second quarter of the previous fiscal year and an increase in depreciation expense resulting from the increase in capital expenditures in the previous fiscal year.

The $199,207 increase in General and Administrative (G&A) expenses for the quarter ended November 30, 2019, primarily reflects increases in administrative labor and related benefits costs of approximately $140,000 and an increase in rent expense of approximately $20,000 compared to similar costs incurred in the second quarter of the previous fiscal year.

The $465,164 increase in operating income primarily reflects the profits earned on a higher volume of commercial contracts revenue during this quarter compared to the second quarter of the previous fiscal year.

Six Months Comparison

The $3,276,491 increase in revenues to $21,290,838 for the six months ended November 30, 2019, compared to $18,014,347 for the six months ended November 30, 2018, is primarily the result of an increase in contract activity in commercial contracts of approximately $3,470,000 compared to the first six months of the previous fiscal year. The increase in revenues was partially offset by decreases in revenue generated by government contracts of approximately $114,600 and federal grants of approximately $81,700. The increase in commercial contract revenues is primarily the result of several new projects starting up for two large pharmaceutical company clients during the second quarter compared to similar projects starting up in the same quarter of fiscal year 2019.

The $1,605,714 increase in contract operating expenses for the six months ended November 30, 2019, primarily reflects increases in expenses incurred of approximately $430,000 related to the purchase of nonhuman primates, higher labor and related benefits costs of approximately $1,000,000, higher contract materials and supplies costs of approximately $450,000 compared to similar costs incurred in the second quarter of the previous fiscal year and an increase in depreciation expense resulting from the increase in capital expenditures in the previous fiscal year. The increases above were partially offset by a $265,000 decrease in subcontractor costs compared to similar costs incurred in the previous fiscal year.

The $227,791 increase in General and Administrative (G&A) expenses for the six months ended November 30, 2019, primarily reflects increases in administrative labor and related benefits costs of approximately $140,000 and an increase in rent expense of approximately $70,000 compared to similar costs incurred in the first six months of the previous fiscal year.

The $1,442,986 increase in operating income primarily reflects the profits earned on a higher volume of commercial contracts during the first six months of fiscal year 2020 compared to the first six months of the previous fiscal year. Additionally, during the first quarter of fiscal year 2020, the Company was successful in negotiating the addition of approximately $300,000 of funding to cover contract costs incurred in the previous fiscal year.

Liquidity and Capital Resources

During the first six months of fiscal year 2020, the Company directed approximately $777,000 towards capital expenditures compared to approximately $798,000 in the first six months of fiscal year 2019. 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, and to renovate animal housing space will total approximately $1,200,000.

In December 2018, the Company entered into an eight-year office and laboratory lease located in Maryland with total lease payments of approximately $4,040,000. The Company has engaged an architectural and engineering (A&E) firm to assist with the design and build-out of approximately 10,700 square feet of space to be utilized as a vivarium. The Company estimates the purchase of approximately $800,000 in infrastructure, cage washing, sanitation, and animal care equipment over the next six months. With the assistance of the A&E firm, the Company is currently determining the construction costs of the vivarium.

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 2020 was approximately $1,893,000. As of November 30, 2019, the total of the future minimum rental payments is approximately $20,396,000.

Other than the items mentioned above, the Company does not anticipate other substantial capital and other expenditures during fiscal year 2020. 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, 2019, 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, 2019, was 5.00%. On November 30, 2019, the Company had a balance of cash and cash equivalents of $6,135,087. 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 2020.

The following provides additional information on select balance sheet items: 1) the $6,226,986 increase in accounts receivable reflects the impact of the second quarter increased volume of commercial contracts activity as well as slower than normal collection of outstanding invoices during the first six months of fiscal year 2020 offset by a decrease in unbilled accounts receivable reflecting the issuance of a several invoices for work recorded in unbilled receivables at May 31, 2019; 2) the $290,894 decrease in accrued compensation and related liabilities primarily reflects the payment of the accrued fiscal year 2019 bonuses during the first quarter of fiscal year 2020; 3) the $268,977 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; and 4) the $2,303,821 increase to deferred revenue primarily reflecting an increase in the amount of advanced billings related to the increased volume of commercial contracts activity during the second quarter of fiscal year 2020.

Additionally, there are several new line items on the balance sheet related to the adoption of Topic 842. The operating lease right-of-use assets and operating lease liabilities balances reflect the Company's future lease commitments. Please refer to the Notes to financial statements for more information related to the adoption of Topic 842. Lastly, please refer to the Statements of Consolidated Cash Flows on Page 5 for further detail related to the changes in cash and cash equivalents.

Notes to financial statements

Leases

The Company adopted ASC Topic 842, *Leases*, on June 1, 2019 using a modified retrospective transition approach. As permitted by ASC 842, the Company elected not to reassess (i) whether any expired or existing contracts are leases or contain leases, (ii) the lease classification of any expired or existing leases, and (iii) the initial direct costs for existing leases.

The Company leases certain assets, consisting primarily of real estate, and assesses at contract inception whether a contract is, or contains, a lease. A right-of-use asset and lease liability is recorded on the balance sheet for all leases except those with an original lease term of twelve months or less. The Company's leases typically have lease terms between three years and ten years and may include one or more renewal options. At lease commencement, the Company assesses whether it is reasonably certain to exercise a renewal option, or reasonably certain not to exercise a termination option, by considering various economic factors. Options that are reasonably certain of being exercised are factored into the determination of the lease term, and related payments are included in the calculation of the right-of-use asset and lease liability.

The Company uses its incremental borrowing rate to calculate the present value of lease payments when the interest rate implicit in a lease is not disclosed. Variable lease payments that are linked to a certain rate or index, such as the CPI, are included in the present value of lease payments and measured using the prevailing rate or index at lease commencement, with changes in the associated rate or index recognized in earnings during the period in which the change occurs. The right-of-use asset and lease liability are not remeasured as a result of any subsequent change in the index or rate unless remeasurement is required for another reason. Variable lease payments that are not linked to a certain rate or index are comprised primarily of operating costs.

The components of total lease cost and other supplemental lease information are presented in the following tables:

	For the Six Months Ended November 30, 2019
Components of lease cost:	
Operating lease costs	1,893,161
Cash paid for amounts included in the measurement of lease liabilities	
Operating cash flows from operating leases	1,706,003
Lease liabilities arising from obtaining ROU assets (subsequent to adoption)	
Operating leases	136,738

Weighted average remaining lease terms and discount rates are presented in the following table:

	November 30, 2019
Weighted average remaining lease term (in years):	
Operating leases	5.65
Weighted average discount rate (annual):	
Operating leases	5.68%

The following table presents a maturity analysis of the Company's operating liabilities at November 30, 2019:

	Operating Leases
Year 1	3,459,392
Year 2	3,643,150
Year 3	3,572,428
Year 4	3,156,756
Year 5	2,851,396
Thereafter	3,712,851
Total lease payments	20,395,973
Less: imputed interest	(3,653,280)
Present value of lease liabilities	16,742,693

Revenue recognition accounting

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, 2019, 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 fixed-price-milestone (FP-M) type contracts, that is 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, 2019, there were no material modifications recorded related to work previously performed on FP-M type 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.

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 Master Service Agreement (MSA) or similar agreements.

As of November 30, 2019, 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, 2019**	**Six Months Ended November 30, 2019**
National Institutes of Health (NIH)		
Cost-Plus-Fixed-Fee	$ 1,870,324	$ 2,902,242
Fixed-Price-Per-Unit and Time-And-Materials	704,621	2,817,290
Fixed-Price-Milestone	101,934	203,868
Total National Institutes of Health	2,676,879	5,923,400
Commercial and Other		
Cost-Plus-Fixed-Fee	480,699	946,426
Fixed-Price-Per-Unit and Time-And-Materials	5,370,882	9,614,177
Fixed-Price-Milestone	2,694,502	4,806,835
Total Commercial and Other	8,546,083	15,367,438
Total Revenues	$ 11,222,962	$ 21,290,838

Cost-plus-fixed-fee (CPFF) contracts are generally lower risk and have lower profits. time-and-materials (T&M) and fixed-price-per-unit (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 fixed-price 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:

Contract asset and liabilities:

		November 30, 2019	June 1, 2019
Contract assets:	Balance sheet line item:		
Unbilled contract receivables (1)	Accounts receivable - contracts	$ 1,961,813	$ 4,591,636
Fulfillment costs	Prepaid expenses	90,701	161,705
		$ 2,052,514	$ 4,753,341
Contract liabilities:	Balance sheet line item:		
Deferred revenue	Deferred revenue	2,573,453	$ 269,632

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 quarter ended November 30, 2019. 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, 2019, the Company recognized revenue of approximately $200,000 relating to amounts that were included as a contract liability at June 1, 2019.

During the six months ended November 30, 2019, the Company recognized approximately $216,500 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, 2019.

(1) 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; 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.