Unaudited Financial Statements and Management's Discussion & Analysis

For the quarterly period ended August 31, 2020

BIOQUAL, INC.

Prepared by:

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Chief Financial Officer

BIOQUAL, INC.

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BIOQUAL, INC.

UNAUDITED BALANCE SHEETS, AUGUST 31, 2020 AND MAY 31, 2020

ASSETS	**August 31, 2020**	May 31, 2020
CURRENT ASSETS:		
Cash and cash equivalents	**$ 5,869,439**	$ 10,256,437
Accounts receivable:		
Trade	**15,957,828**	10,378,195
Unbilled – current	**3,455,923**	4,071,024
Prepaid expenses	**1,388,957**	1,360,954
Income taxes receivable	**0**	188,300
Total current assets	**26,672,147**	26,254,910
FIXED ASSETS:		
Leasehold improvements	**5,514,605**	5,514,605
Furniture, fixtures and equipment	**14,050,827**	13,582,937
Total	**19,565,432**	19,097,542
Less accumulated depreciation and amortization	**(12,752,263)**	(12,450,988)
Fixed assets, net	**6,813,169**	6,646,554
OTHER ASSETS:		
Other intangibles, net	**3,415**	5,975
Goodwill	**1,028,408**	1,028,408
Operating lease right-of-use assets	**15,423,325**	14,849,174
Cash value of officers' life insurance policies	**763,347**	763,347
Total other assets	**17,218,495**	16,646,904
TOTAL	**$ 50,703,811**	$ 49,548,368
LIABILITIES		
CURRENT LIABILITIES:		
Accounts payable	**1,666,910**	2,476,101
Accrued compensation and related liabilities	**637,937**	1,504,216
Accrued income taxes	**522,600**	0
Operating lease liabilities, current	**3,061,310**	2,873,963
Deferred revenue	**745,823**	828,183
Total current liabilities	**6,634,580**	7,682,463
Deferred income taxes	**412,700**	412,700
Operating lease liabilities, non-current	**13,704,454**	13,271,008
Total liabilities	**20,751,734**	21,366,171
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 $.01 per share; 5,000,000 shares authorized; 1,599,408 shares issued; 894,416 shares outstanding	**15,994**	15,994
Additional paid-in capital	**7,363,453**	7,360,161
Retained earnings	**23,613,870**	21,847,282
Treasury stock, at cost	**(1,041,240)**	(1,041,240)
Total stockholders' equity	**29,952,077**	28,182,197
TOTAL	**$ 50,703,811**	$ 49,548,368

See Management's Discussion and Analysis.

BIOQUAL, INC.
UNAUDITED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED AUGUST 31,

	2020	2019
REVENUES:		
Contract revenues	**$14,920,475**	$ 10,067,876
Total Revenues	**14,920,475**	10,067,876
OPERATING EXPENSES:		
Contract	**10,973,407**	7,054,541
General and administrative	**1,450,763**	1,166,768
Total Operating Expenses	**12,424,170**	8,221,309
OPERATING INCOME	**2,496,305**	1,846,567
INTEREST EXPENSE	**(0)**	(6,304)
INTEREST INCOME	**683**	34,220
INCOME BEFORE INCOME TAXES	**2,496,988**	1,874,483
PROVISION FOR INCOME TAXES	**(730,400)**	(550,000)
NET INCOME	**$ 1,766,588**	$ 1,324,483
BASIC EARNINGS PER SHARE	**$ 1.98**	$ 1.48
DILUTED EARNINGS PER SHARE	**$ 1.98**	$ 1.48
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR BASIC EARNINGS PER SHARE	**893,416**	893,416
EFFECT OF DILUTIVE SECURITIES – RESTRICTED SHARES	**614**	232
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR DILUTED EARNINGS PER SHARE	**894,030**	893,648

See Management’s Discussion and Analysis.

BIOQUAL, Inc.

Unaudited Statements of Stockholders' Equity

	Common Stock		Treasury Stock				
	Shares	Amount	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Total
Balance, June 1, 2020	1,599,408	15,994	704,992	(1,041,240)	7,360,161	21,847,282	28,182,197
Stock compensation expense	-	-	-	-	3,292	-	3,292
Net Income	-	-	-	-	-	1,766,588	1,766,588
Balance August 31, 2020	1,599,408	15,994	704,992	(1,041,240)	7,363,453	23,613,870	29,952,077

	Common Stock		Treasury Stock				
	Shares	Amount	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Total
Balance, June 1, 2019	1,599,408	$ 15,994	704,992	$ (1,041,240)	$ 7,346,994	$18,242,435	$ 24,564,183
Stock compensation expense	-	-	-	-	3,290	-	3,290
Net Income	-	-	-	-	-	1,324,483	1,324,483
Balance August 31, 2019	1,599,408	15,994	704,992	(1,041,240)	7,350,284	19,566,918	25,891,956

See Management's Discussion and Analysis.

BIOQUAL, INC.
UNAUDITED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED AUGUST 31,

	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	**$ 1,766,588**	$ 1,324,483
Adjustments to reconcile net income to net cash		
provided by operating activities:		
Depreciation and amortization	**303,835**	209,246
Amortization of operating lease right-of-use asset	**726,466**	775,554
Stock compensation expense	**3,292**	3,290
(Increase) decrease in		
Accounts receivable	**(4,964,532)**	(1,172,494)
Prepaid expenses	**160,297**	(561,964)
Increase (decrease) in		
Accounts payable	**(809,191)**	(402,811)
Accrued compensation and related liabilities	**(866,279)**	(497,219)
Operating lease liability	**(679,824)**	(652,494)
Accrued income taxes	**522,600**	460,500
Deferred revenue	**(82,360)**	(8,685)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**(3,919,108)**	(522,594)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	**(467,890)**	(344,631)
NET CASH USED BY INVESTING ACTIVITIES	**(467,890)**	(344,631)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(4,386,998)**	(867,225)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	**10,256,437**	9,207,608
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 5,869,439**	$ 8,340,383
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	**$ 0**	$ 6 ,304
Income Taxes	**$ 30,000**	$ 0
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Recognition of ROU asset	**$ 16,149,791**	$ 16,989,707
Recognition of operating lease liability	**$ 18,073,284**	$ 17,787,513
Derecognition of deferred rent liability	**$ 0**	$ 797,806

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.

Items of Note

In the first quarter of fiscal year 2021, which commenced on June 1, 2020, the Company realized net income of $1,766,588, a 33.4% increase compared to net income of $1,324,483 for the first quarter of fiscal year 2020. See Results of Operations below for more detail on the increase in net income.

During the first quarter of fiscal year 2021, the National Institute of Allergies and Infectious Diseases (NIAID) provided $238,225 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 $2,461,275 to $2,699,500. The contract period of performance end date was September 30, 2020. There are, however, no assurances that the Company will be awarded any other task orders under the PCMID Master Contract.

Subsequent to the end of the first quarter of fiscal year 2021, the NIAID provided $8,125,898 of incremental funding for the first option year of the contract entitled "Animal Care and Laboratory Support Services to the Vaccine Research Center." The seven-year contract has a maximum potential funding amount of $69,174,672 including all options. The cumulative funding of the contract increased from $7,883,552 to $16,009,450. The incremental funding covers costs incurred from September 28, 2020 through September 27, 2021. There are, however, no assurances that any other options will be exercised under this contract.

Based on fiscal year 2020 earnings, the Board of Directors declared a cash dividend of $1.10 per share for shareholders of record on September 28, 2020. The dividend is scheduled to be paid on October 21, 2020. This amount is $.40 per share greater than the $.70 per share cash dividend paid on October 16, 2019.

COVID-19

During the first quarter of fiscal year 2021, the Company began work on forty-four (44) new contracts to support COVID-19 related research and vaccine development. Seven (7) of the 44 new contracts were executed with clients new to BIOQUAL. Subsequent to the end of the first quarter, the Company entered into an additional twenty (20) new COVID-19 related contracts, five (5) of which are for new clients.

During fiscal year 2021, in collaboration with other organizations, BIOQUAL staff have been listed as co-authors of several peer reviewed articles in scientific journals. Certain data included in the articles were obtained during studies performed in our laboratories. Several of the articles are available for review on the Company's website (www.bioqual.com).

For a number of years, BIOQUAL has been engaged in development of in-vivo testing programs and has been extensively involved in research efforts to develop vaccines and therapies against emerging diseases including AIDS, Hepatitis, Zika, Chikungunya and others. The Company has increased its focus on COVID-19 research and is positioned to play an important role in the development of vaccines and therapies against this epidemic.

Results of Operations

Three Months Comparison

The $4,852,599 increase in revenues to $14,920,475 for the quarter ended August 31, 2020, compared to $10,067,876 for the quarter ended August 31, 2019, is primarily the result of an increase in contract activity in commercial contracts of approximately $6,006,000 compared to the first quarter of the previous fiscal year. Additionally, revenues for grants increased by approximately $26,000 compared to the first quarter of the previous fiscal year. The increase in revenues was partially offset by a decrease in revenue generated by government contracts of approximately $1,179,000. The increase in commercial contract revenues is primarily the result of new COVID-19 related contracts. The decrease in government contracts is primarily due to the completion of several task orders with no new task orders awarded during this quarter.

The $3,918,866 increase in contract operating expenses for the quarter ended August 31, 2020, primarily reflects increases in expenses incurred of approximately $2,250,000 related to the purchase of nonhuman primates, higher labor and related benefits costs of approximately $850,000, higher contract materials and supplies costs of approximately $567,000 and higher depreciation and facilities related costs of approximately $200,000 compared to similar costs incurred in the first quarter of the previous fiscal year.

The $283,995 increase in General and Administrative (G&A) expenses for the quarter ended August 31, 2020, primarily reflects increases in administrative labor and related benefits costs of approximately $167,500 and higher consultants and accounting fees of approximately $88,000 compared to similar costs incurred in the first quarter of the previous fiscal year.

The $649,738 increase in operating income primarily reflects the profits earned on a higher volume of commercial contracts revenue during this quarter compared to the first quarter of the previous fiscal year.

Liquidity and Capital Resources

During the first three months of fiscal year 2021, the Company directed approximately $468,000 towards capital expenditures compared to approximately $345,000 in the first three months of fiscal year 2020. These expenditures were necessary to provide additional equipment and nonhuman primate (NHP) and rodent cages for research being performed in the Company's laboratories including approximately $82,000 for items to support COVID-19 research contracts. 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 nine 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.

The Company is presently in the permitting phase of construction of approximately 10,700 square feet of space in its 9600 Medical Center Dr. facility to be utilized as a vivarium for small animals. The Company estimates the purchase of an additional $800,000 in infrastructure, cage washing, sanitation, and animal care equipment over the next three to six months. With the assistance of the A&E firm, the Company is currently determining the construction costs of the vivarium. The construction costs are presently estimated at between $2,000,000 and $4,000,000. Management is developing its approach to funding the construction costs for this project. Based on discussion with the Architecture & Engineering firm, the Company anticipates the vivarium will be operational not earlier than January 2021.

The Company is obligated, as lessee, under non-cancelable operating leases covering its facilities and certain equipment at various dates through 2027. Rent expense for the first three months of fiscal year 2021 was approximately $959,000. As of August 31, 2020, the total of the future minimum rental payments is approximately $19,959,000.

During the first quarter of fiscal year 2021, the Company entered into a lease for 9,416 square feet of office space located at 9620 Medical Center Drive, Rockville, Maryland for a term of seven years and four months including an option for 5 additional years, with total lease payments of approximately $1,387,000. The lease commenced on July 1, 2020 and the Company will utilize this space to accommodate the expected continued growth of its staff and to provide adequate space for social distancing until the end of the COVID-19 pandemic.

Other than the items mentioned above, the Company does not anticipate other substantial capital and other expenditures during fiscal year 2021. 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 August 31, 2020, 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 August 31, 2020, was 3.50%. On August 31, 2020, the Company had a balance of cash and cash equivalents of $5,869,439. 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 2021.

The following provides additional information on select balance sheet items: 1) the $4,964,532 increase in accounts receivable primarily reflects the impact of the increased volume of commercial contracts activity as well as slower collection of outstanding invoices compared to the end of the previous fiscal year. The increase in accounts receivable is partially off-set by a decrease in unbilled accounts receivable reflecting the issuance of a several invoices for work recorded in unbilled receivables at May 31, 2020; 2) the $866,279 decrease in accrued compensation and related liabilities primarily reflects the payment of the accrued fiscal year 2020 bonuses during the first quarter of fiscal year 2021; and 3) the $809,191 decrease in accounts payable reflects a lower total amount of outstanding invoices for the purchase of nonhuman primates as compared to the end of the previous fiscal year.

During the previous fiscal year and continuing into fiscal year 2021, the Company temporarily shifted its focus away from supporting AIDS, influenza and other infectious disease research to apply the majority of its resources to supporting the global need for vaccines and therapeutics to combat COVID-19. Although the Company had a few non-COVID-19 contracts cancelled, the lost revenue was replaced by contracts related to potential COVID-19 vaccines and therapeutics. During the first quarter of fiscal year 2021, the Company began performing non-COVID-19 contract work again, although approximately 50% of the revenues generated this quarter were in support of COVID-19 related research.

In response to the effects on the economy of COVID-19, the Company continues to stay in contact with its critical suppliers to ensure the continued delivery of necessary materials to keep our employees safe and healthy at the workplace as well as to continue to provide animal husbandry and required procedures for our clients. To date, the Company has been able to procure adequate quantities of critical materials and supplies to continue operations. Based on market demand, the Company has had to pay higher prices for certain critical items which may have a short-term negative impact on the results of operations. There are, however, no assurances that BIOQUAL will be able to continue obtaining such critical materials without interruption.

Notes to financial statements

Risks and uncertainties

The expanding coronavirus outbreak (COVID-19) could adversely impact the Company's operations, suppliers or other vendors, and customer base. Any quarantines, labor shortages or other disruptions to operations, or those of customers, may adversely impact the Company's revenues, ability to deliver its services, and operating results. In addition, a widespread health crisis will adversely affect the local and global economies, resulting in an economic downturn that could affect demand for the Company's services, collectability of receivables, and valuation of investments. Management is unable to predict the near and long-term effects on the Company.

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 Three Months Ended August 31, 2020
Components of lease cost:	
Operating lease costs	958,375
Cash paid for amounts included in the measurement of lease liabilities	
Operating cash flows from operating leases	911,732
Lease liabilities arising from obtaining ROU assets (subsequent to adoption)	
Operating leases	113,487

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

	August 31, 2020
Weighted average remaining lease term (in years):	
Operating leases	5.24
Weighted average discount rate (annual):	
Operating leases	5.56%

The following table presents a maturity analysis of the Company's operating liabilities at August 31, 2020:

	Operating Leases
Year 1	3,917,867
Year 2	3,920,712
Year 3	3,538,560
Year 4	3,237,675
Year 5	2,074,322
Thereafter	3,269,417
Total lease payments	19,958,553
Less: imputed interest	(3,192,789)
Present value of lease liabilities	16,765,764

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 August 31, 2020, the Company had negotiated final settlements on indirect cost rates through 2014. 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 three months ended August 31, 2020, 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 August 31, 2020, 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	Year Ended August 31, 2020
National Institutes of Health (NIH)	
Cost-Plus-Fixed-Fee	$ 2,092,958
Fixed-Price-Per-Unit and Time-And-Materials	-
Fixed-Price-Milestone	-
Total National Institutes of Health	2,092,958
Commercial and Other	
Cost-Plus-Fixed-Fee	626,193
Fixed-Price-Per-Unit and Time-And-Materials	7,938,458
Fixed-Price-Milestone	4,262,866
Total Commercial and Other	12,827,517
Total Revenues	$ 14,920,475

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:

		August 31, 2020	June 1, 2020
Contract assets:	Balance sheet line item:		
Unbilled contract receivables (1)	Accounts receivable - contracts	$3,455,922	$ 4,071,024
Fulfillment costs	Prepaid expenses	462,228	901,356
		$3,918,150	$ 4,972,380
Contract liabilities:	Balance sheet line item:		
Deferred revenue	Deferred revenue	$ 745,823	$ 828,183

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 August 31, 2020. The increase in "Contract liabilities- current" was primarily due to billings in excess of revenue recognized on certain FP-M contracts.

During the three months ended August 31, 2020, the Company recognized revenue of approximately $395,000 relating to amounts that were included as a contract liability at June 1, 2020.

During the three months ended August 31, 2020, the Company recognized approximately $807,300 of amortization related to its fulfillment costs. The Company did not recognize any impairment losses on contract assets for the three months ended August 31, 2020.

(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.