Unaudited Financial Statements and Management's Discussion & Analysis

For the quarterly period ended <u>August 31, 2021</u>

<u>BIOQUAL, INC.</u>

Prepared by:

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Chief Financial Officer

BIOQUAL, INC.

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Financial Statements.

BIOQUAL, INC.
UNAUDITED BALANCE SHEETS, AUGUST 31, 2021 AND MAY 31, 2021

ASSETS	**August 31, 2021**	May 31, 2021
CURRENT ASSETS:		
Cash and cash equivalents	**$ 7,983,353**	$ 7,719,702
Accounts receivable:		
Trade	**14,055,358**	14,564,386
Unbilled – current	**5,614,968**	5,544,089
Prepaid expenses	**1,428,487**	1,493,503
Total current assets	**29,082,166**	29,321,680
PROPERTY AND EQUIPMENT:		
Leasehold improvements	**8,634,333**	7,611,183
Furniture, fixtures and equipment	**16,484,422**	15,894,816
Total	**25,118,755**	23,505,999
Less accumulated depreciation and amortization	**(14,208,127)**	(13,810,121)
Property and equipment, net	**10,910,628**	9,695,878
OTHER ASSETS:		
Goodwill	**1,028,408**	1,028,408
Operating lease right-of-use assets	**12,481,858**	13,262,424
Cash value of officers' life insurance policies	**111,750**	111,750
Total other assets	**13,622,016**	14,402,582
TOTAL	**$ 53,614,810**	$ 53,420,140
LIABILITIES		
CURRENT LIABILITIES:		
Accounts payable	**1,757,841**	2,107,723
Accrued compensation and related liabilities	**1,161,882**	2,148,788
Accrued income taxes	**661,800**	81,900
Operating lease liabilities, current	**3,217,073**	3,303,062
Deferred revenue	**1,257,654**	875,721
Total current liabilities	**8,056,250**	8,517,194
Deferred income taxes	**57,700**	57,700
Operating lease liabilities, non-current	**10,593,918**	11,315,309
Total liabilities	**18,707,868**	19,890,203
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 $.01 per share; 5,000,000 shares authorized; 1,599,408 shares issued; 894,416 shares outstanding	**15,994**	15,994
Additional paid-in capital	**7,364,934**	7,364,934
Retained earnings	**28,567,254**	27,190,249
Treasury stock, at cost	**(1,041,240)**	(1,041,240)
Total stockholders' equity	**34,906,942**	33,529,937
TOTAL	**$ 53,614,810**	$ 53,420,140

See Management's Discussion and Analysis.

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

	2021	2020
REVENUES:		
Contract revenues	**$15,472,759**	$ 14,920,475
Total Revenues	**15,472,759**	14,920,475
OPERATING EXPENSES:		
Contract	**11,811,440**	10,973,407
General and administrative	**1,715,571**	1,450,763
Total Operating Expenses	**13,527,011**	12,424,170
OPERATING INCOME	**1,945,748**	2,496,305
INTEREST EXPENSE	**(0)**	(0)
INTEREST INCOME	**657**	683
INCOME BEFORE INCOME TAXES	**1,946,405**	2,496,988
PROVISION FOR INCOME TAXES	**(569,400)**	(730,400)
NET INCOME	**$ 1,377,005**	$ 1,766,588
BASIC EARNINGS PER SHARE	**$ 1.54**	$ 1.98
DILUTED EARNINGS PER SHARE	**$ 1.54**	$ 1.98
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR BASIC EARNINGS PER SHARE	**894,416**	893,416
EFFECT OF DILUTIVE SECURITIES – RESTRICTED SHARES	**1**	614
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING FOR DILUTED EARNINGS PER SHARE	**894,417**	894,030

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, 2021	1,599,408	15,994	704,992	(1,041,240)	7,364,934	27,190,249	33,529,937
Net Income	-	-	-	-	-	1,377,005	1,377,005
Balance August 31, 2021	1,599,408	15,994	704,992	(1,041,240)	7,364,934	28,567,254	34,906,942

	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

See Management's Discussion and Analysis.

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

	2021	2020
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	**$ 1,377,005**	$ 1,766,588
Adjustments to reconcile net income to net cash		
provided by (used by) operating activities:		
Depreciation and amortization	**398,006**	303,835
Amortization of operating lease right-of-use asset	**780,566**	726,466
Stock compensation expense	**0**	3,292
(Increase) decrease in		
Accounts receivable	**438,149**	(4,964,532)
Prepaid expenses	**65,016**	160,297
Increase (decrease) in		
Accounts payable	**(349,882)**	(809,191)
Accrued compensation and related liabilities	**(986,906)**	(866,279)
Operating lease liabilities	**(807,380)**	(679,824)
Accrued income taxes	**579,900**	522,600
Deferred revenue	**381,933**	(82,360)
NET CASH PROVIDED BY (USED BY) OPERATING ACTIVITIES	**1,876,407**	(3,919,108)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	**(1,612,756)**	(467,890)
NET CASH USED BY INVESTING ACTIVITIES	**(1,612,756)**	(467,890)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**263,651**	(4,386,998)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	**7,719,702**	10,256,437
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 7,983,353**	$ 5,869,439
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	**$ 0**	$ 0
Income Taxes	**$ 0**	$ 30,000
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Recognition of ROU asset	**$ 0**	$ 16,149,791
Recognition of operating lease liability	**$ 0**	$ 18,073,284

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 2022, which commenced on June 1, 2021, the Company realized net income of $1,377,005, a 22.1% decrease compared to net income of $1,766,588 for the first quarter of fiscal year 2021. See Results of Operations below for more detail on the decrease in net income.

Subsequent to the end of the first quarter of fiscal year 2022, the National Institute of Allergy and Infectious Diseases (NIAID) provided $1,492,302 of incremental funding for the second option year of the contract entitled "Animal Care and Laboratory Support Services to the Vaccine Research Center." Additionally, subsequent to the end of the first quarter, the NIAID provided funding of $681,000 to purchase a needed PET/CT equipment for use on the contract. 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 $14,009,450 to $18,182,752. The incremental funding covers costs incurred from September 28, 2021, through September 27, 2022. There are, however, no assurances that any other options will be exercised under this contract.

Also subsequent to the end of the first quarter, the NIAID awarded BIOQUAL with a third task order under the contract entitled "Simian Vaccine Evaluation Units (SVEUs)" totaling $1,413,583 including all options. The current funding is $530,959 which covers costs from September 8, 2021, until March 8, 2024. The seven-year contract has a maximum potential funding amount of $6,682,071 including all options. The cumulative funding of the contract increased from $1,175,098 to $1,706,057. There are, however, no assurances that any other options will be exercised or task orders awarded under this contract.

Based on fiscal year 2021 earnings, the Board of Directors declared a cash dividend of $1.25 per share for shareholders of record on September 29, 2021. The dividend was paid on October 20, 2021. This amount is $.15 per share greater than the $1.10 per share cash dividend paid on October 21, 2020.

COVID-19

BIOQUAL staff have been listed as co-authors of several peer reviewed COVID-19 related 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).

BIOQUAL continues to attract COVID-19 related contracts due to its experience working with the virus and its capacity to perform research in a Biosafety Level 3 (BSL-3) environment. Approximately, 40% of the revenues generated this quarter were in support of COVID-19 related research. The Company is also performing in-vivo and in-vitro studies to assist the federal government, universities and commercial organizations with their research efforts to develop vaccines and therapies against emerging diseases including AIDS, Zika, Chikungunya and others, including influenza.

Results of Operations

Three Months Comparison

The $552,284 increase in revenues to $15,472,759 for the quarter ended August 31, 2021, compared to $14,920,475 for the quarter ended August 31, 2020, is primarily the result of an increase in contract activity in commercial contracts of approximately $438,000 compared to the first quarter of the previous fiscal year. Additionally, revenues for grants increased by approximately $262,000 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 $148,000.

The $838,033 increase in contract operating expenses for the quarter ended August 31, 2021, primarily reflects increases in expenses incurred of approximately $1,300,000 in operations labor and related benefits costs reflecting the effect of continued hiring of staff to support the increasingly complex operational and regulatory issues involved in performing services for our clients as well as keeping pace with increased contract activity. The increase in contract operating expenses is partially offset by a decrease of approximately $475,000 in contract materials and supplies when compared to similar costs incurred in the previous fiscal year.

The $264,808 increase in General and Administrative (G&A) expenses for the quarter ended August 31, 2021, primarily reflects increases in administrative labor and related benefits costs and temporary labor compared to similar costs incurred in the first quarter of the previous fiscal year. The increased labor costs (both employees and non-employee) reflect the increased administrative effort needed to keep pace with the increased contract activity.

The $550,557 decrease in operating income primarily reflects the increased costs related to indirect (infrastructure) positions necessary to support the increasingly complex operational and regulatory issues involved in performing services (including COVID-19 related contracts) for our clients 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 2022, the Company directed approximately $1,613,000 towards capital expenditures compared to approximately $468,000 in the first three months of fiscal year 2021. 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 $800,000.

In addition to the $800,000 described in the previous paragraph, the Company estimates that it will purchase an additional $400,000 in infrastructure, cage washing, sanitation, and animal care equipment over the next three to six months in connection with the 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 construction phase is on-going. The total construction costs are currently estimated at between $4,000,000 and $4,500,000, of which, the Company incurred approximately $3,295,000 as of August 31, 2021. The estimated construction costs total does not include the $400,000 for equipment mentioned earlier in this paragraph. Management may fund the construction either by using its cash reserves, line of credit, obtaining a construction loan or a combination of any of the above. To date, all construction related costs have been paid using cash on hand.

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 2022 was approximately $979,000. As of August 31, 2021, the total of the future minimum rental payments is approximately $15,660,000.

Subsequent to the end of the first quarter of fiscal year 2022, the Company entered into a lease for 8,876 square feet of additional office space located at 9600 Medical Center Drive, Rockville, Maryland for a term of four and one-half years, with total lease payments of approximately $1,070,000. The lease commenced on October 1, 2021, and the Company will utilize this space to accommodate the expected continued growth of its laboratory and quality control/assurance staff.

Other than the items mentioned above, the Company does not anticipate other substantial capital and other expenditures during fiscal year 2022. 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, 2021, 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, 2021, was 3.50%. On August 31, 2021, the Company had a balance of cash and cash equivalents of $7,983,353. 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 2022.

The following provides additional information on select balance sheet items: 1) the $986,906 decrease in accrued compensation and related liabilities primarily reflects the payment of the accrued fiscal year 2021 bonuses during the first quarter of fiscal year 2022; 2) the $349,882 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 as well as amounts outstanding for other various materials suppliers; and 3) the $381,933 increase in deferred revenue reflects an increase in the amount of advanced billings related to commercial contracts during the first quarter of fiscal year 2022.

Notes to financial statements

Risks and uncertainties

Over the past year, to keep up with the increased number of contracts and the increased complexity of the COVID related contracts, the Company has increased its workforce by approximately 25%. Coupled with the increased number of employees, in order to compete with the other laboratories seeking a similar workforce, the Company has had to alter its salary structure by increasing the pay rates of certain labor categories to attract and retain employees needed to enable the Company to meet the increased demand for its services. To date, the Company has been relatively successful in acquiring sufficient staffing to keep up with contract demand. There are, however, no assurances that the Company will be able to continue to hire a sufficient number of employees to meet future contract demand.

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 its 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.

A significant part of the research support services provided by BIOQUAL requires the use of nonhuman primates, which continue to be difficult to procure in adequate quantities to satisfy the demand for continuing COVID-19 vaccine and therapeutics development as well as research of other infectious diseases. The Company continues to work closely with its suppliers and is committing (providing cash deposits) to the purchase of nonhuman primates as soon as they become available in order to have a pipeline of animals for future studies. China, a major breeder and supplier of nonhuman primates, ceased exporting nonhuman primates in 2020. The resumption of exporting nonhuman primates by China would help alleviate the shortage of this important component of infectious disease research; however, there is no assurance that this will happen, and a continued shortage of nonhuman primates could adversely affect the Company's ability to perform new projects.

Leases

The Company enters into leases as a lessee for certain buildings and equipment. The Company's leases typically have lease terms between three years and ten years and may include one of more renewal options. Under Accounting Standards Codification (ASC) Topic 842, *Leases,* at contract inception the Company determines whether a contract is or contains a lease and whether the lease should be classified as an operating or finance lease. Operating leases balances are included in the operating lease right-of-use assets and operating lease liabilities in the accompanying Balance Sheets for the quarter ended August 31, 2021, and the year ended May 31, 2021.

The Company recognizes operating lease right-of-use assets and operating lease liabilities based on the present value of the future minimum lease payments over the lease term at the commencement date. The Company uses its incremental borrowing rate based on the information available at the commencement date to determine the present value of future payments and the appropriate lease classification. Many of the Company's leases include renewal options aligned with any extended contract terms. The Company defines the initial lease term to include renewal options determined to be reasonably certain. When the Company adopted AC 842, it elected not to recognize a right-of-use asset and a lease liability for leases with an initial term of 12 months or less; it recognizes lease expense for these leases on a straight-line basis over the lease term. The Company also elected not to separate lease components from non-lease components and applied this to all material classes of leased assets.

Finance leases are not material to the Company's financial statements and the Company is not a lessor in any material arrangements. The Company does not have any material restrictions or covenants in the lease agreements, sale-leaseback transactions, land easements or residual value guarantees.

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

	For the Three Months Ended August 31, 2021
Components of lease cost:	
Operating lease costs	979,087
Cash paid for amounts included in the measurement of lease liabilities	
Operating cash flows from operating leases	(350,047)
Lease liabilities arising from obtaining ROU assets (subsequent to adoption)	
Operating leases	-

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

Weighted average remaining lease term (in years):	August 31, 2021
Operating leases	4.46
Weighted average discount rate (annual):	
Operating leases	5.53%

The following table presents a maturity analysis of the Company's operating liabilities at August 31, 2021:

	Operating Leases
Year 1	3,934,371
Year 2	3,552,220
Year 3	3,256,413
Year 4	2,118,573
Year 5	1,730,044
Thereafter	1,068,492
Total lease payments	15,660,114
Less: imputed interest	(1,849,122)
Present value of lease liabilities	13,810,991

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, 2021, the Company had negotiated final settlements on indirect cost rates through 2016. 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, 2021, 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, 2021, 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, 2021**
National Institutes of Health (NIH)	
Cost-Plus-Fixed-Fee	$ 2,141,012
Fixed-Price-Per-Unit and Time-And-Materials	65,878
Fixed-Price-Milestone	-
Total National Institutes of Health	2,206,890
Commercial and Other	
Cost-Plus-Fixed-Fee	201,459
Fixed-Price-Per-Unit and Time-And-Materials	9,167,052
Fixed-Price-Milestone	3,897,358
Total Commercial and Other	13,265,869
Total Revenues	$ 15,472,759

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, 2021	**June 1, 2021**
Contract assets:	Balance sheet line item:		
Unbilled contract receivables [(1)]	Accounts receivable - contracts	$ 5,516,368	$ 5,544,089
Fulfillment costs	Prepaid expenses	908,502	1,135,135
		$ 6,424,870	$ 6,679,224
Contract liabilities:	Balance sheet line item:		
Deferred revenue	Deferred revenue	$ 1,257,654	$ 875,721

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, 2021. 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, 2021, the Company recognized revenue of approximately $400,000 relating to amounts that were included as a contract liability at June 1, 2021.

During the three months ended August 31, 2021, the Company recognized approximately $601,000 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, 2021.

(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. The forward-looking statements are neither promises nor guarantees, and one should not place undue reliance on these forward-looking statements because they involve known and unknown risks, uncertainties, and other factors, many of which are beyond the Company’s control and which could cause actual results to differ materially from those expressed or implied by these forward-looking statements, 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 obtain sufficient numbers of animal models; the availability of adequate numbers of employees; 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.