# HYDROMER, INC. and CONSOLIDATED SUBSIDIARY

## Consolidated Financial Statements

## September 30, 2014

# HYDROMER, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

| | Three Months Ended September 30, | |
|---|---|---|
| | **2014** | **2013** |
| **Revenues** | | |
| Sales of Products | **$ 789,164** | $ 698,378 |
| Service Revenues | **395,971** | 341,824 |
| Royalties and contract revenues | **290,637** | 344,339 |
| **Total Revenues** | **1,475,772** | 1,384,541 |
| **Expenses** | | |
| Cost of Sales | **402,039** | 395,042 |
| Operating Expenses | **1,018,453** | 899,301 |
| Other Expenses | **40,191** | 46,044 |
| Provision for Income Taxes | **7,352** | 1,000 |
| **Total Expenses** | **1,468,035** | 1,341,387 |
| **Net Income** | **$ 7,737** | $ 43,154 |
| Earnings Per Common Share* | **$ 0.00** | $ 0.01 |
| Weighted Average Number of Common Shares Outstanding* | **4,772,318** | 4,772,318 |

*There are no Common Stock Equivalents (e.g. Options), hence dilutive earnings per share = basic earnings per share.

See accompanying notes.

The accompanying notes are an integral part of these consolidated financial statements.

*This report may contain forward-looking statements, which include, among other things, business strategy and expectations concerning industry conditions, market position, future operations, margins, profitability, liquidity and capital resources. Forward-looking statements generally can be identified by the use of terminology such as "may," "will," "expect," "intend," "estimate," "anticipate" or "believe" or similar expressions or the negatives thereof. These expectations are based on management's assumptions and current beliefs based on currently available information. Although the Company believes that the expectations reflected in such statements are reasonable, it can give no assurance that such expectations will be correct. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report and the Company does not have any obligation to update the forward-looking statements. The Company's operations are subject to a number of uncertainties, risks and other influences, many of which are outside its control, and any one of which, or a combination of which, could cause its actual results of operations to differ materially from the forward-looking statements.*

# HYDROMER, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

| | September 30, **2014** (unaudited) | June 30, 2014 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | **$ 689,426** | $ 545,686 |
| Trade Receivables less allowance for doubtful accounts of $25,754 and $33,605 as of September 30, 2014 and June 30, 2014, respectively | **771,016** | 880,700 |
| Inventory | **347,868** | 365,024 |
| Prepaid Assets | **104,440** | 150,529 |
| Deferred tax asset, non-current | **65,318** | **68,634** |
| Other | **4,520** | 10,651 |
| Total Current Assets | **1,982,588** | 2,021,224 |
| Property and Equipment, net | **2,423,457** | 2,431,234 |
| Deferred tax asset, non-current | **1,097,077** | 1,100,613 |
| Intangible assets, net | **792,019** | 804,149 |
| Other | **77,948** | 79,295 |
| Total Assets | **$ 6,373,089** | $ 6,436,515 |
| LIABILITIES & EQUITY | | |
| Current Liabilities: | | |
| Accounts Payable | **$ 136,492** | $ 237,118 |
| Accrued Expenses | **302,277** | 234,833 |
| Current portion of deferred revenue | **80,229** | 93,599 |
| Current portion of mortgage payable | **84,042** | 82,042 |
| Total Current Liabilities | **604,040** | 647,592 |
| Deferred Tax Liability | **303,130** | 303,130 |
| Long term portion of deferred revenue | **48,801** | 54,733 |
| Long term portion of mortgage payable | **2,477,262** | 2,498,936 |
| Total Liabilities | **3,433,233** | 3,504,391 |
| Contingencies | - | - |
| Equity: | | |
| Preferred Stock - no par value, authorized 1,000,000 shares; no shares issued and outstanding | - | - |
| Common Stock - no par value, authorized 15,000,000 shares; 4,783,235 shares issued and 4,772,318 shares outstanding as of September 30, 2014 and June 30, 2014 | **3,721,815** | 3,721,815 |
| Contributed capital | **633,150** | 633,150 |
| Accumulated deficit | **(1,408,969)** | (1,416,701) |
| Treasury stock, 10,917 common shares at cost | **(6,140)** | (6,140) |
| Total Stockholders' Equity | **2,939,856** | 2,932,124 |
| Total Liabilities and Stockholders' Equity | **$ 6,373,089** | $ 6,436,515 |

See accompanying notes.

# HYDROMER, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

| | Three months ended September 30, | |
|---|---|---|
| | **2014** | 2013 |
| Cash Flows from Operating Activities: | | |
| Net Income | **$ 7,737** | $ 43,154 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and Amortization | **102,257** | 88,746 |
| Deferred income taxes | **6,852** | - |
| Changes in Assets and Liabilities: | | |
| Trade receivables | **109,684** | 246,144 |
| Inventory | **17,156** | 22,126 |
| Prepaid expenses | **14,240** | 5,991 |
| Other assets | **7,478** | 2,088 |
| Accounts payable and accrued liabilities | **(32,737)** | (164,601) |
| Deferred income | **(19,302)** | (12,954) |
| Income taxes payable | **1,000** | (1,000) |
| Net Cash Provided by Operating Activities | **214,365** | 229,694 |
| Cash Flows from Investing Activities: | | |
| Cash purchases of property and equipment | **(28,851)** | (26,180) |
| Cash payments on patents and trademarks | **(22,100)** | (22,857) |
| Net Cash Used in Investing Activities | **(50,951)** | (49,037) |
| Cash Flows from Financing Activities: | | |
| Repayment of long-term borrowings | **(19,674)** | (14,961) |
| Net Cash Used in Financing Activities | **(19,674)** | (14,961) |
| Net Increase in Cash and Cash equivalents | **143,740** | 165,696 |
| Cash and Cash equivalents, Beginning of Period | **545,686** | **458,954** |
| Cash and Cash equivalents, End of Period | **$ 689,426** | $ 624,650 |

See accompanying notes.

# HYDROMER, INC.

**Notes to Condensed Consolidated Financial Statements**

Basis of Presentation:

In the opinion of management, the accompanying unaudited condensed financial statements include all adjustments (consisting of only normal adjustments) necessary for a fair presentation of the results for the interim periods. These condensed financial statements, including notes, do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America. Accordingly, the condensed financial statements should be read in conjunction with the consolidated financial statements and other information contained in our Annual Report for the year ended June 30, 2014. The condensed consolidated financial statements and notes have not been reviewed by the Company's independent public accountants.

Segment Reporting:

The Company operates two primary business segments. The Company evaluates the segments by revenues, total expenses and earnings before taxes. Corporate Overhead (primarily the salaries and benefits of senior management, support services (Accounting, Legal, Human Resources and Purchasing) and other shared services (building maintenance and warehousing)) are excluded from the business segments as to not distort the contribution of each segment. These segments are the lowest levels for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities.

The results for the three months ended September 30, by segment are:

| **2014** | Polymer Research | Medical Products | Corporate Overhead | Total |
|---|---|---|---|---|
| Revenues | $ 1,112,977 | $ 362,795 | | $ 1,475,772 |
| Expenses | (826,762) | (246,300) | $ (387,621) | (1,460,683) |
| Pre-tax Income (Loss) | $ 286,215 | $ 116,495 | $ (387,621) | $ 15,089 |
| | | | | |
| 2013 | | | | |
| Revenues | $ 1,048,458 | $ 336,083 | | $ 1,384,541 |
| Expenses | (730,886) | (254,821) | (354,680) | (1,340,387) |
| Pre-tax Income (Loss) | $ 317,572 | $ 81,262 | $ (354,680) | $ 44,154 |

Subsequent Events:

During the quarter ended March 31, 2014, the Company wrote off a $180,000 receivable and subsequently initiated legal action to collect. On November 7, 2014, the Company accepted a settlement of $135,000 in cash to resolve all matters and avoid any protracted and costly litigation costs. This transaction will be recorded in the quarter ended December 31, 2014.

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

Results of Operations

The Company's revenues for the quarter ended September 30, 2014 were $1,475,772, $91,231 or 6.6% higher than the $1,384,541 for the same period the previous year. Revenues are comprised of the sale of Products and Services and Royalty and Contract payments.

Product sales were $789,164 for the quarter ended September 30, 2014 as compared to $698,378 for the same period the year before, higher by $90,786 (13.0%) primarily due to stronger Industrial Anti-fog sales during the quarter. This year-over-year improvement for the three month period includes the impact from lower than typical sales in the previous year.

Services revenues, comprising of contract coating services, for the three months ended September 30, 2014 was $395,971 or $54,147 (15.8%) better than the $341,824 the corresponding period the year before reflecting the continued demand for our services.

Royalty and Contract revenues include royalties received and the periodic recurring payments from license, stand still and other agreements other than for product and services. Included in Royalty and Contract revenues are revenues from support and supply agreements which avails our customers to continued technical support and/or guaranteed access to our proprietary coatings and may include the transfer of technical know-how (coatings procedures). Some of the royalties and support fees are based on the net sales of the final item (to which the Hydromer technology is applied to) and are subject to the reporting of our customers. For the quarter ended September 30, 2014, Royalty and Contract revenues were $290,637, compared to $344,339 the same period a year ago. An agreement which accounted for $35,000 during the previous year's quarter was cancelled following non-payment of previous amounts due. (See **Subsequent Events** on page 5 for related information)

Total Expenses for the quarter ended September 30, 2013 were $1,468,035 as compared with $1,341,387 the year before, higher by $126,648 or 9.4%.

For the quarter ended September 30, 2014, the Company's Cost of Goods Sold was $402,039 as compared with $395,042 the year prior, higher by $6,997 or 1.8%. Higher product sales during the current quarter resulted in a higher Cost of Goods Sold.

Operating expenses were $1,018,453 for the quarter ended September 30, 2014 as compared with $899,301 the year before, higher by $119,152 or 13.2%. Higher staffing levels in Research & Development plus higher patent amortization costs were the primarily factors behind the increase.

Interest expense, interest income and other income are included in Other Expenses. Interest expense (primarily mortgage interest) for the three months ended September 30, 2014 and September 30, 2013 were $33,696 and $47,535, respectively, lower due to the mortgage rate reset in October 2013.

With the Company's return to profitability, tax credits were no longer required to have a valuation allowance placed against them. Accordingly, a tax provision is recorded for the current quarter (albeit only a minimal cash payment is required). For the previous year's quarter, any required tax provision was essentially offset by the recovery of tax credits previously reserved for.

Net income of $7,737 ($0.00 per share) is reported for the quarter ended September 30, 2014 as compared to a net income of $43,154 ($0.01 per share) the year before.

Although the Company is reporting $91,231 in higher revenues this quarter when compared with the corresponding quarter a year ago, higher "reinvestment" expenses reduced the current period's results. These "reinvestment" expenses includes higher Research and Development staffing and higher amortization of patent costs incurred during the past year. These expenses provides for a greater long term return than toward the current period.

Financial Condition

The working capital position as of September 30, 2014 was $1,379,048 as compared with $1,373,632 as of June 30, 2014 or better by $4,916 during the comparative three month period.

For the three months ended September 30, 2014, operating activities provided $214,365 in net cash.

> Collection of trade receivables ($109,684) and the non-cash depreciation and amortization expense ($102,257) were the primary contributors to the net cash provided by operating activities.

Investing activities used $50,951 and financing activities used $19,674 during the three months ended September 30, 2014.

> Investing activities for the three months ended September 30, 2014 included $28,851 for capital expenditures and $22,100 towards the Company's patent estate. Reported under Financing activities was the repayment of the principal portion of the mortgage.

EBITDA for the quarter ended September 30, 2014 was $151,042: Depreciation of property, plant and equipment and amortization of the patent estate totaled $102,257, interest expense was $33,696 and the Provision for Income Taxes was $7,352. This compares with EBITDA of $180,435 for the previous year's quarter ended September 30, 2013.