

# **HYDROMER, INC. and CONSOLIDATED SUBSIDIARY**

## **Consolidated Financial Statements**

**December 31, 2016**



# HYDROMER, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2016	2015	2016	2015
<b>Revenues</b>				
Sales of Products	\$749,942	\$ 824,331	\$ 1,465,677	\$ 1,622,266
Service Revenues	276,508	271,739	659,928	581,687
Royalties and contract revenues	375,759	276,727	685,799	563,084
<b>Total Revenues</b>	<b>1,402,209</b>	<b>1,372,797</b>	<b>2,811,404</b>	<b>2,767,037</b>
<b>Expenses</b>				
Cost of Sales	420,095	474,928	801,091	834,811
Operating Expenses	885,261	1,061,647	1,912,106	2,083,995
Other (Income) Expenses	30,960	24,424	64,498	59,948
Provision for (Benefit from) Income Taxes	26,317	(75,169)	14,236	(80,186)
<b>Total Expenses</b>	<b>1,362,633</b>	<b>1,485,830</b>	<b>2,791,931</b>	<b>2,898,568</b>
<b>Net Income (Loss)</b>	<b>\$ 39,576</b>	<b>\$ (113,033)</b>	<b>\$ 19,473</b>	<b>\$ (131,531)</b>
Earnings (Loss) Per Common Share*	\$ 0.01	\$ (0.02)	\$ 0.00	\$ (0.03)
Weighted Average Number of Common Shares Outstanding	4,772,318	4,772,318	4,772,318	4,772,318

\* Diluted EPS and Basic EPS are the same as the Company does not have any Common Stock Equivalents (e.g. Options).

<b>Income taxes paid</b>	<b>\$ 1,375</b>	<b>\$ 1,000</b>	<b>\$ 1,375</b>	<b>\$ 2,000</b>
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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.

## CONSOLIDATED BALANCE SHEETS

	December 31, 2016 (unaudited)	June 30, 2016
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 305,320	\$ 330,165
Trade Receivables less allowance for doubtful accounts of \$3,036 as of December 31, 2016 and \$12,039 as of June 30, 2016	981,549	936,519
Inventory	524,349	506,900
Prepaid Assets	118,294	188,661
Deferred tax asset	59,886	72,747
Other	15,944	3,550
<b>Total Current Assets</b>	<b>2,005,342</b>	<b>2,038,542</b>
Property and Equipment, net	2,220,933	2,271,610
Deferred tax asset, non-current	1,227,341	1,227,341
Intangible assets, net	626,005	678,378
Other	79,999	70,980
<b>Total Assets</b>	<b>\$ 6,159,620</b>	<b>\$ 6,286,851</b>
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts Payable	\$ 404,966	\$ 412,705
Accrued Expenses	162,340	233,087
Current portion of deferred revenue	10,576	30,527
Current portion of mortgage payable	93,684	91,447
<b>Total Current Liabilities</b>	<b>671,566</b>	<b>767,766</b>
Deferred Tax Liability	258,328	258,328
Long term portion of deferred revenue	17,490	21,528
Long term portion of mortgage payable	2,276,299	2,322,765
<b>Total Liabilities</b>	<b>3,223,683</b>	<b>3,370,387</b>
Contingencies	-	-
Stockholders' 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 December 31, 2016 and June 30, 2016	3,721,815	3,721,815
Contributed capital	633,150	633,150
Accumulated deficit	(1,412,888)	(1,432,361)
Treasury stock, 10,917 common shares at cost	(6,140)	(6,140)
<b>Total Stockholders' Equity</b>	<b>2,935,937</b>	<b>2,916,464</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 6,159,620</b>	<b>\$ 6,286,851</b>

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

# HYDROMER, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Six Months Ended December 31,	
	2016	2015
Cash Flows from Operating Activities:		
Net Income (Loss)	\$ 19,472	\$ (131,531)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and Amortization	193,653	191,624
Deferred income taxes	12,861	(81,686)
Changes in Assets and Liabilities:		
Trade receivables	(45,030)	452,990
Inventory	(17,449)	(41,454)
Prepaid expenses	59,315	37,881
Other assets	(21,413)	2,191
Accounts payable and accrued liabilities	(78,485)	(43,561)
Deferred revenue	(23,989)	(94,771)
Net Cash Provided by Operating Activities	98,935	291,683
Cash Flows from Investing Activities:		
Cash purchases of property and equipment	(16,495)	(35,746)
Cash payments on patents and trademarks	(63,056)	(75,951)
Net Cash Used in Investing Activities	(79,551)	(111,697)
Cash Flows from Financing Activities:		
Repayment of long-term borrowings	(44,229)	(42,355)
Net Cash Used in Financing Activities	(44,229)	(42,355)
Net Increase (Decrease) in Cash and Cash equivalents	(24,845)	137,631
Cash and Cash equivalents, Beginning of Period	330,165	464,699
Cash and Cash equivalents, End of Period	\$ 305,320	\$ 602,330

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

# 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, 2016. 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 six months ended December 31, by segment are:

	Polymer <u>Research</u>	Medical <u>Products</u>	Corporate <u>Overhead</u>	<u>Total</u>
<b>2016</b>				
Revenues	\$ 2,165,569	\$ 645,835		\$ 2,811,404
Expenses	(1,437,655)	(531,404)	\$ (808,637)	(2,777,696)
Pre-tax Income (Loss)	<u>\$ 727,914</u>	<u>\$ 114,431</u>	<u>\$ (808,637)</u>	<u>\$ 33,708</u>
<b>2015</b>				
Revenues	\$ 2,234,331	\$ 532,706		\$ 2,767,037
Expenses	(1,645,823)	(521,486)	\$ (811,445)	(2,978,754)
Pre-tax Income (Loss)	<u>\$ 588,508</u>	<u>\$ 11,220</u>	<u>\$ (811,445)</u>	<u>\$ (211,717)</u>

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

### **Results of Operations**

The Company's revenues were \$1,402,209 for the quarter ended December 31, 2016, \$29,412 or 2.1% higher than the \$1,372,797 for the same period the previous year. Revenues for the six month period ended December 31, 2016 were \$2,811,404, as compared with \$2,767,037 for the same period the year before or \$44,367 higher (1.6%). Revenues are comprised of the sale of Products and Services and Royalty and Contract payments.

Product sales were \$749,942 for the quarter ended December 31, 2016 as compared to \$824,331 for the same period the year before, a \$74,389 decrease (9.0%). For the six month period, product sales were \$1,465,677 for the 2016 period as compared with \$1,622,266 for the 2015 period, a decrease of \$156,589 (9.7%). The 2015 period included higher sales of our medical chemical coatings and \$190,080 in cyclical private label T-HEXX DRY sales not occurring in 2016. Offsetting the lower sales in medical chemical coating sales of \$161,081 and T-HEXX DRY were \$115,498 of higher sales this year from our Industrial Anti-fog and T-HEXX International units reflecting stronger demand.

Services revenues, comprising of contract coating services, for the three months ended December 31, 2016 was \$276,508 or \$4,769 higher (1.8%) than the \$271,739 the corresponding period the year before. For the six month periods ended December 31, 2016 and December 31, 2015, services revenues were \$659,928 and \$581,687, respectively or \$78,241 higher (13.5%). New customers accounted for \$48,585 of additional service revenues this year-to-date.

Royalty and Contract revenues are 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 provides 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) and are subject to the reporting from our customers. As part of its general monitoring of its customers and business activity, the Company determined that two licensees did not report commencement of their sales to which the Company's support fees were based. The Company agreed upon a collective \$57,750 of prior support fees with its licensees that is included in the current period. This is in addition to the recurring \$17,500 in quarterly support fees from these two licensees that is also included in the results of the current period. Accordingly, for the six months ended December 31, 2016, Royalty and Contract revenues were \$685,799 or \$122,715 (21.8%) higher than the prior year's \$563,084.

Total Expenses for the quarter ended December 31, 2016 were \$1,362,633 as compared with \$1,485,830 the year before, a 8.3% decrease. For the six months ended December 31, 2016, Total Expenses were \$2,791,931 as compared with \$2,898,568 the previous year, a 3.7% decrease.

For the quarter ended December 31, 2016, the Company's Cost of Goods Sold was \$420,095 as compared with \$474,928 the year prior, lower by \$54,833 or 11.5%. For the six month period ended December 31, 2016, Cost of Goods Sold was \$801,091 as compared with \$834,811 the same period a year ago, a \$33,720 or 4.0% decrease. Lower product sales resulted in the lower Cost of Goods Sold which was partially offset by a product mix change (more lower product margin products sold this year).

Operating expenses were \$885,261 for the quarter ended December 31, 2016 as compared with \$1,061,647 the year before, lower by \$176,386 or 16.6%. For the six months ended December 31, 2016, Operating expenses were \$1,912,106 or \$171,889 lower (8.2%) than the previous year's \$2,083,995, primarily from lower sales and marketing expenditures including advertising and tradeshows, and non-recurring expenses included in the 2015 periods.

Other (Income) Expenses includes interest expense, foreign currency exchange gains/losses, interest income and other income. Interest expense (primarily mortgage interest) for the six months ended December 31, 2016 and December 31, 2015, were \$64,961 and \$65,516, respectively.

Net income of \$39,576 (\$0.01 per share) is reported for the quarter ended December 31, 2016 as compared to a net loss of \$113,033 (\$0.02 per share) the year before. For the six months ended December 31, 2016, net income of \$19,473 (\$0.00 per share) is reported as compared to a net loss of \$131,531 (\$0.03 per share) the year before.

Higher revenue levels, including a product mix of the more higher margin coating services and royalties and contract revenues, but moreso lower expenses resulted in the turnaround.

### Financial Condition

Working capital increased \$63,000 during the six months ended December 31, 2016.

For the six months ended December 31, 2016, operating activities provided \$98,935 in net cash.

Net income, as adjusted for the non-cash depreciation and amortization expense, provided \$213,125 in cash. The net change in operating assets and liabilities used \$103,062 in cash, with the collections of trade accounts receivable and accounts payable and accrued expenses accounting for \$123,515 of that change.

Investing activities used \$79,551 and financing activities used \$44,229 during the six months ended December 31, 2016.

Investing activities for the six months ended December 31, 2016 included \$16,495 for capital expenditures and \$63,056 towards the Company's patent estate. Under Financing activities was the repayment of the principal portion of the mortgage.

EBITDA for the six months ended December 31, 2016 was \$292,322: Depreciation of property, plant and equipment and amortization of the patent estate totaled \$193,653, interest expense was \$64,961 and the Provision for Income Taxes was \$14,236. This compares with EBITDA of \$45,423 for the six month period ending December 31, 2015, the difference due to the net income this period as opposed to a net loss in the prior year-to-date. Impacting the operating results and EBITDA are the Company's continued reinvestment expenses, which includes the cost of the Research and Development team for future product developments that do not yield any revenues in the current term. For the six months ended December 31, 2016 and 2015, direct R&D expenses (including salaries) aggregated \$155,173 and \$181,783, respectively.