

HYDROMER, INC. and CONSOLIDATED SUBSIDIARY

Consolidated Financial Statements

March 31, 2017



HYDROMER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2017	2016	2017	2016
Revenues				
Sales of Products	\$602,753	\$ 809,820	\$ 2,068,430	\$ 2,432,086
Service Revenues	259,646	376,348	919,574	958,035
Royalties and contract revenues	249,426	250,574	935,224	813,658
Total Revenues	1,111,825	1,436,742	3,923,228	4,203,779
Expenses				
Cost of Sales	323,071	435,072	1,124,192	1,269,883
Operating Expenses	1,046,223	1,084,487	2,958,329	3,168,482
Other (Income) Expenses	31,859	33,376	96,358	93,324
Provision from Income Taxes	(110,131)	(43,894)	(95,895)	(124,080)
Total Expenses	1,291,022	1,509,041	4,082,984	4,407,609
Net Loss	\$ (179,197)	\$ (72,299)	\$ (159,756)	\$ (203,830)
Loss Per Common Share*	\$ (0.04)	\$ (0.02)	\$ (0.03)	\$ (0.04)
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).

Income taxes paid	\$ 563	\$ 750	\$ 1,938	\$ 2,250
--------------------------	---------------	---------------	-----------------	-----------------

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

	March 31, 2017 (unaudited)	June 30, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 166,487	\$ 330,165
Trade Receivables less allowance for doubtful accounts of \$3,830 as of March 31, 2017 and \$12,039 as of June 30, 2016	666,755	936,519
Inventory	544,818	506,900
Prepaid Assets	181,436	188,661
Deferred tax asset	72,139	72,747
Other	13,719	3,550
Total Current Assets	1,645,354	2,038,542
Property and Equipment, net	2,222,951	2,271,610
Deferred tax asset, non-current	1,325,906	1,227,341
Intangible assets, net	615,681	678,378
Other	78,194	70,980
Total Assets	\$ 5,888,086	\$ 6,286,851
LIABILITIES & STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts Payable	\$ 318,102	\$ 412,705
Accrued Expenses	183,196	233,087
Current portion of deferred revenue	8,388	30,527
Current portion of mortgage payable	94,825	91,447
Total Current Liabilities	604,511	767,766
Deferred Tax Liability	258,328	258,328
Long term portion of deferred revenue	16,408	21,528
Long term portion of mortgage payable	2,252,131	2,322,765
Total Liabilities	3,131,378	3,370,387
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 March 31, 2017 and June 30, 2016	3,721,815	3,721,815
Contributed capital	633,150	633,150
Accumulated deficit	(1,592,117)	(1,432,361)
Treasury stock, 10,917 common shares at cost	(6,140)	(6,140)
Total Stockholders' Equity	2,756,708	2,916,464
Total Liabilities and Stockholders' Equity	\$ 5,888,086	\$ 6,286,851

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

HYDROMER, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Nine Months Ended March 31,	
	2017	2016
Cash Flows from Operating Activities:		
Net Loss	\$ (159,756)	\$ (203,830)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and Amortization	292,992	288,487
Deferred income taxes	(97,957)	(126,330)
Changes in Assets and Liabilities:		
Trade receivables	269,764	316,895
Inventory	(37,918)	(82,968)
Prepaid expenses	(6,634)	(25,100)
Other assets	(17,382)	2,890
Accounts payable and accrued liabilities	(144,497)	(28,328)
Deferred revenue	(27,258)	(101,210)
Net Cash Provided by Operating Activities	71,354	40,506
Cash Flows from Investing Activities:		
Cash purchases of property and equipment	(52,757)	(52,386)
Cash payments on patents and trademarks	(115,019)	(110,257)
Net Cash Used in Investing Activities	(167,776)	(162,643)
Cash Flows from Financing Activities:		
Repayment of long-term borrowings	(67,256)	(63,946)
Net Cash Used in Financing Activities	(67,256)	(63,946)
Net Decrease in Cash and Cash equivalents	(163,678)	(186,083)
Cash and Cash equivalents, Beginning of Period	330,165	464,699
Cash and Cash equivalents, End of Period	\$ 166,487	\$ 278,616

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 nine months ended March 31, by segment are:

	Polymer <u>Research</u>	Medical <u>Products</u>	Corporate <u>Overhead</u>	<u>Total</u>
2017				
Revenues	\$ 3,043,936	\$ 879,292		\$ 3,923,228
Expenses	(2,097,024)	(829,422)	\$ (1,252,431)	(4,178,877)
Pre-tax Income (Loss)	<u>\$ 946,912</u>	<u>\$ 49,870</u>	<u>\$ (1,252,431)</u>	<u>\$ (255,649)</u>
2016				
Revenues	\$ 3,193,026	\$ 1,010,753		\$ 4,203,779
Expenses	(2,463,596)	(882,490)	\$ (1,185,603)	(4,531,689)
Pre-tax Income (Loss)	<u>\$ 729,430</u>	<u>\$ 128,263</u>	<u>\$ (1,185,603)</u>	<u>\$ (327,910)</u>

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

Results of Operations

The Company's revenues for the quarter ended March 31, 2017 were \$1,111,825 compared to the \$1,436,742 for the same period the year before (\$324,917 or 22.6% lower). For the nine month period ended March 31st, revenues were \$3,923,228 during the current fiscal year, as compared with \$4,203,779 the year before or \$280,551 lower (6.7%). Revenues are comprised of the sale of Products and Services and Royalty and Contract payments.

Product sales were \$602,753 for the quarter ended March 31, 2017 as compared to \$809,820 for the same period the previous year, a decline of \$207,067 (25.6%). For the nine month period ended March 31, 2017, product sales were \$2,068,430 compared with \$2,432,086 from the same period a year ago (15.0% or 363,656 lower). In the 2016 period we had a stronger demand for our medical chemical coatings as one customer was building up inventory, as well as \$190,080 of private label T-HEXX DRY orders not mirrored in the current year combined with a timing of orders in the international business of T-HEXX

Services revenues, comprising of contract coating services, for the three months ended March 31, 2017 were \$259,646 or \$116,702 lower (31.0%) than the \$376,348 the corresponding period the year before. For the nine month periods ended March 31, 2017 and 2016, services revenues were \$919,574 and \$958,035, respectively, or \$38,461 lower (4.0%). There was a timing of customer activity (decline) during the three month period as the nine month year-to-date periods reflect a fairly level comparative total.

Classified as 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. Also included in Royalty and Contract revenues are revenues from support and supply agreements which avail our customers continued technical support and/or guaranteed access to our proprietary coatings and may include the transfer of technical know-how. 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 of our customers. For the nine months ended March 31, 2017, Royalty and Contract revenues were \$935,224, compared with \$813,658 the same period a year ago, an increase of \$121,566 (14.9%). As reported for our December 2016 results, \$57,750 was for a catch-up of under reported support fees.

Total Expenses for the quarter ended March 31, 2017 were \$1,291,022 as compared with \$1,509,041 the year before, a \$218,019 (14.4%) decrease. For the nine months ended March 31, 2017, Total Expenses were \$4,082,984 as compared with \$4,407,609 the previous year-to-date, lower by \$324,625 or 7.4%.

For the quarter ended March 31, 2017, the Company's Cost of Goods Sold was \$323,071 as compared with \$435,072 the year prior, a decrease of \$112,001 or 25.7%. For the nine month period ended March 31, 2017, Cost of Goods Sold was \$1,124,192 as compared with \$1,269,883 the same period a year ago. A lower Sales of Products level as offset by a product mix change resulted in a \$145,691 (11.5%) decrease to Cost of Sales for the nine month period.

Operating expenses were \$1,046,223 for the quarter ended March 31, 2017 as compared with \$1,084,487 the year before, lower by \$38,264 or 3.5%. For the nine months ended March 31, 2017, Operating expenses were \$2,958,329 or \$210,153 lower (6.6%) than the previous year's \$3,168,482. Cost reduction initiatives including elimination or reduction of sales support (third party sales rep), advertising and tradeshows and business strategy support were taken.

Interest expense, foreign currency exchange gains/losses, interest income and other income are included in Other Expenses. Interest expense (primarily mortgage interest) for the nine months ended March 31, 2017 and March 31, 2016 were \$95,873 and \$97,538, respectively.

A net loss of \$179,197 (\$0.04 per share) is reported for the quarter ended March 31, 2017 as compared to \$72,299 (\$0.02 per share) the year before. A net loss of \$159,756 (\$0.03 per share) is reported for the nine months ended March 31, 2017 as compared to \$203,830 (\$0.04 per share) the year before.

The timing of customer orders resulted in overall lower revenues. The Company reduced some of its expenditures (primarily in sales related areas) to partially offset the lower sales. We look for an improvement in revenues from the correction of the timing difference and from entry into new markets and from new product introductions, including that of our all natural HerbaSafe™ consumer product line of a foaming hand soap, Triclosan free hand sanitizer and hand lotion.

Financial Condition

Working capital decreased \$229,933 during the nine months ended March 31, 2017.

For the nine months ended March 31, 2017, operating activities provided \$71,354 in net cash.

The net loss, as adjusted for the non-cash depreciation and amortization and deferred income taxes, provided \$35,279 in cash. The net change in operating assets and liabilities provided for an additional \$36,075 in cash, primarily from the collections of accounts receivable as offset by the other assets and liabilities categories.

Investing activities used \$167,776 in cash and financing activities used \$67,256 during the nine months ended March 31, 2017.

Investing activities for the nine months ended March 31, 2017 included \$52,757 for capital expenditures and \$115,019 towards the Company's patent estate. Reported under Financing activities was the repayment of the principal portion of the mortgage.

EBITDA for the nine months ended March 31, 2017 was \$134,168: Depreciation of property, plant and equipment and amortization of the patent estate totaled \$292,992, interest expense was \$96,827 and the benefit from Income Taxes was \$95,895. This compares with EBITDA of \$59,987 for the nine month period ending March 31, 2016. The higher EBITDA for the nine month period ending March 31, 2017 as compared to the same period a year before is from the cost reduction initiatives taken. 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 nine months ended March 31, 2017 and 2016, direct R&D expenses (including salaries) aggregated \$239,465 and \$261,720, respectively.