

2017 ANNUAL REPORT

Aerospace

Sound Deadening

Weight Reduction

Electronics

Printed Electronics

Wafer Fabrication

Inkjet Technology

Mold Texturing

3D Texture Prototyping

Photo Tools

Screen Print Chemistry

Emulsions

Films

Custom Coating

Decorative

Dye Sublimation

Sandcarving

Screen Stencils



Letter to Shareholders

The year was adversely affected by a temporary slowdown of orders from our largest aerospace customer due to a manufacturing problem. The problem, which was internal to that customer, was resolved in the fourth quarter. Sales for IKONICS in the fourth quarter of 2017 reached an all-time quarterly record. Indications are that this trend will continue, setting a strong pace for 2018.

My goal has been to diversify our business to become less dependent on screen-print chemistry and decorative sand blasting and to enter larger and more dynamic markets. These efforts are starting to bear fruit. Aerospace, in spite of the temporary 2017 problem, is a growing part of our business, as are automotive and electronics. Late last year we entered the robust dye-sublimation market with a patent-pending product, and I anticipate important new products will be launched in 2018.

Earnings for 2017 showed a loss of \$226,000, although earnings for the fourth quarter of 2017 were \$0.19 per diluted share. Sales were down 2% for the year, but the lower sales were partially offset by a 102% increase in sales to the automotive industry and a stocking order for our new SubTHAT! dye-sublimation products.

The list of products on the cover page of this report indicates our product range. Some of these are well established while others, such as electronics, are just beginning to gain traction. All of these products are based on our four technology platforms: UV chemistry; film coating and construction; industrial inkjet printing, and precision abrasive etching – a technology mix that I believe is unique for a company our size.

Where we can utilize a mix of these technologies in a product, such as with our automotive offering, I believe we have a competitive advantage, a strong IP position, and high margins.

Other positive trends for 2018, including but not limited to the reduction in the corporate federal income tax rate from 35% to 21%, improved distribution for exports and the continuance of a cost-reduction initiative, which already has had a positive effect on fourth-quarter results, also should contribute to growth and profits in 2018.

William C. Ulland

Chairman, President & CEO

March 23, 2018

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2017

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Transition Period From _____ to _____

Commission file number 000-25727

IKONICS CORPORATION

(Exact name of registrant as specified in its charter)

Minnesota
(State or other jurisdiction of
incorporation or organization)

41-0730027
(I.R.S. employer
identification no.)

4832 Grand Avenue
Duluth, Minnesota
(Address of principal executive offices)

55807
(Zip code)

Registrant's telephone number, including area code: **(218) 628-2217**

Securities registered under Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, par value \$.10 per share	Nasdaq Capital Market

Securities registered under Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes No

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained in this form, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Smaller reporting company

Accelerated filer

Emerging Growth Company

Non-accelerated filer (do not check if smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2017 was \$12,454,213 based on the most recent closing price for the issuer's Common Stock on such date as reported on the Nasdaq Capital Market. For purposes of determining this number, all officers and directors of the issuer are considered to be affiliates of the issuer, as well as individual stockholders holding more than 10% of the issuer's outstanding Common Stock. This number is provided only for the purpose of this report on Form 10-K and does not represent an admission by either the issuer or any such person as to the status of such person.

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practical date: Common Stock, \$.10 par value — 1,983,553 issued and outstanding as of February 23, 2018.

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended, relating to future events or the future financial performance of the Company. In some cases, you can identify forward-looking statements by the following words: “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “ongoing,” “plan,” “potential,” “predict,” “project,” “should,” “will,” “would,” or the negative of these terms or other comparable terminology, although not all forward-looking statements contain these words. Forward-looking statements are only predictions or statements of intention subject to risks and uncertainties and actual events or results could differ materially from those projected. Forward-looking statements are based on information available at the time the statements are made and involve known and unknown risks, uncertainties and other factors that may cause our results, levels of activity, performance or achievements to be materially different from the information expressed or implied by the forward-looking statements in this Annual Report on Form 10-K. Factors that could cause actual results to differ include the risks, uncertainties and other matters set forth below under the caption “Risk Factors” and the matters set forth under the captions “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” as well as those discussed elsewhere in this Annual Report on Form 10-K.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company’s definitive proxy statement for its 2018 Annual Meeting of Shareholders are incorporated by reference in Part III.

PART I

Item 1. Business

General

IKONICS Corporation (“IKONICS” or the “Company”) was incorporated in Minnesota as Chroma-Glo, Inc. in 1952 and changed its name to The Chromaline Corporation in 1982. In December 2002, the Company changed its name to IKONICS Corporation. The Company’s three traditional businesses, Domestic, IKONICS Imaging and Export, have been the development, manufacture and selling of photosensitive liquids (“emulsions”) and films for the screen printing awards and recognition industries and dye sublimation markets. These sales have been augmented with inkjet receptive films, ancillary chemicals and related equipment to provide a full line of products and services to its customers. These products are sold worldwide primarily through distributors. In 2006, the Company began a major effort to diversify and expand its business to industrial markets. These efforts now include the Company’s Advanced Material Solutions (“AMS”) business unit which uses the Company’s proprietary processes and photoresist film for the abrasive etching of composite materials, industrial ceramics, silicon wafers, and glass wafers. The customer base for AMS is primarily the aerospace and electronics industries. Based on its expertise in ultraviolet curable fluids and inkjet receptive substrates, the Company has also developed a patented digital texturing technology (“DTX”) for putting patterns and textures into steel molds for the plastic injection molding industry. The original equipment manufacturer (“OEM”) for the Company’s DTX technology is primarily the automotive industry. The Company offers a suite of products to the mold making industry. Industrial inkjet printers, which are integral to the DTX system, are manufactured by a third party and sold by IKONICS. The Company’s business plan is to sell consumable fluids and transfer films. For most markets, these sales are direct to the mold maker. The DTX technology is also utilized in prototyping where the Company’s technology offers a unique combination of high definition, large format prints, and abrasion resistance.

Products

The Company has four primary technology platforms: ultraviolet (UV) chemistry, film coating and construction, technical abrasive etching, and industrial inkjet printing. The Company’s traditional products and new initiatives are based on these platforms and their combinations. The Company’s Chromaline branded products for the screen printing industry and IKONICS Imaging products for the awards and recognition market are based on UV chemistry and film coating and construction capabilities; the AMS offering is a combination of UV chemistry, film coating and construction and technical abrasive etching capabilities; DTX is a combination of UV chemistry, film coating and construction, and industrial inkjet printing. There is overlap and synergy in the market between the Domestic, Ikonics Imaging, AMS and DTX product offerings, and the Company offers ancillary products, including equipment to provide customers with a total solution. The Company considers this combination of core technologies and product offerings to be unique.

Distribution and Customers

The Company currently has approximately 200 domestic and international distributors for its Chromaline and ImageMate screen printing emulsions and films. The Company’s abrasive etching products are mainly sold directly to end users in the awards and recognition market under the Ikonics Imaging brand. AMS products are sold either directly to users or the Company offers AMS as a service. DTX includes the sales of consumable inks and films to customers that have purchased specialized industrial inkjet printers from the Company’s strategic partner. DTX sales are both direct to users and through distributors. The Company markets and sells its products through magazine advertising, trade shows and the internet.

The Company has a diverse customer base both domestically and abroad, with international sales accounting for 31.0% of total sales in 2017 and 28.0% of total sales in 2016, and does not depend on one or a few customers for a material portion of its revenues. In 2017 and 2016, no one customer accounted for more than 10% of net sales.

Quality Control in Manufacturing

In March 1994, IKONICS became the first company in northern Minnesota to receive ISO 9001 certification. ISO 9000 is a worldwide standard issued by the International Organization for Standardization that provides a framework for quality assurance. The Company has been recertified every three years beginning in

1997. IKONICS' quality function goal is to train all employees properly in both their work and in the importance of their work. Internal records of quality, including related graphs and tables, are reviewed regularly and discussions are held among management and employees regarding how improvements might be realized. The Company has rigorous materials selection procedures and also uses testing procedures to assure its products meet quality standards.

Research and Development and Intellectual Property

The Company incurred costs totaling 4.0% of sales, or \$689,000, on research and development in 2017, and 3.7% of sales, or \$647,000, in 2016. In its research program, IKONICS has developed ultraviolet light-sensitive chemistries used in the manufacturing of screen print stencils, photoresists for abrasive etching and acid resist and prototyping ink jet fluids and ink jet receptive films. The Company has a number of patents and patent applications on these chemistries and applications. There can be no assurance that any patent granted to the Company will provide adequate protection to the Company's intellectual property. Within the Company, steps are taken to protect the Company's trade secrets, including physical security, confidentiality and non-competition agreements with employees, non-disclosure agreements where applicable, and confidentiality agreements with vendors. Over the past few years, the Company has directed a larger portion of its research and development resources towards industrial inkjettable fluids and ink jet receptive substrates along with dye sublimation films. The Company has also invested significant resources for personnel and equipment to develop proprietary products and techniques for the etching of composite materials, industrial ceramics and electronic wafers.

In addition to its patents, the Company has various trademarks including the "IKONICS," "Chromaline," "IKONICS Imaging," "Precision Abrasive Machining," "SmartFlex," "PhotoBrasive," "AccuArt," "Nichols," "image mate," "Alpha FlexTrace," "Alpha MicroCap," "DTX" and "SubTHAT!" trademarks.

Raw Materials

The primary raw materials used by IKONICS in its production are photopolymers, polyester films, polyvinylacetates, polyvinylalcohols and water. The Company's purchasing staff leads in the identification of both domestic and foreign sources for raw materials and negotiates price and terms for all domestic and foreign markets. IKONICS' involvement in foreign markets has given it the opportunity to become a global buyer of raw materials at lower overall cost. The Company has a number of suppliers for its operations. Some suppliers provide a significant amount of key raw materials to the Company, but the Company believes alternative sources are available for most materials. For those raw materials where an alternative source is not readily available, the Company has contingency raw material replacement plans. To date, there have been no significant shortages of raw materials. The Company believes it has good supplier relations.

Competition

The Company competes in its markets based on product development capability, quality, reliability, availability, technical support and price. Though the screen printing market is much larger than the awards and recognition market, IKONICS commands significantly more market share in the latter. IKONICS has two primary domestic competitors in its screen printing film business. They are larger than IKONICS and possess greater resources than the Company in many areas. The Company has numerous competitors in the market for screen print emulsions, many of whom are larger than IKONICS and possess greater resources. The market for the Company's abrasive etching products in the awards and recognition market has one significant competitor. IKONICS considers itself to be the leader in this market. There are significant competitors, using different technologies in the new markets being entered by the Company. The primary competition for AMS is from other machining methods, most of which are well established. The primary competition for DTX comes from old, well-established technologies based on wax and screen printing and new competition from laser technologies.

Government Regulation

The Company is subject to a variety of federal, state and local industrial laws and regulations, including those relating to the discharge of material into the environment and protection of the environment. The governmental authorities primarily responsible for regulating the Company's environmental compliance are the Environmental Protection Agency, the Minnesota Pollution Control Agency and the Western Lake Superior Sanitary District. Failure to comply with the laws promulgated by these authorities may result in monetary sanctions, liability for environmental

clean-up and other equitable remedies. To maintain compliance, the Company may make occasional changes in its waste generation and disposal procedures.

These laws and regulations have not had a material effect upon the capital expenditures or competitive position of the Company. The Company believes that it complies in all material respects with the various federal, state and local regulations that apply to its current operations. Failure to comply with these regulations could have a negative impact on the Company's operations and capital expenditures and such negative impact could be significant.

The Company also is subject to regulations from foreign governments covering the importation of certain chemicals. The Company believes that it complies in all material respects with these regulations that apply to its current products. Failure to comply with these regulations could have a negative impact on the Company's operations and capital expenditures and such negative impact could be significant.

Employees

As of February 23, 2018, the Company had 83 full-time employees, 78 of whom are located at the Company's two facilities in Duluth, Minnesota and five of whom are outside technical sales representatives in various locations in the United States. None of the Company's employees are subject to a collective bargaining agreement and the Company believes that its employee relations are good.

Item 1A. Risk Factors

The Company's DTX and AMS initiatives involve new technologies that might not be executed successfully and might not achieve market acceptance.

The Company's DTX and AMS initiatives involve new technologies that might never achieve market acceptance. During 2017 and 2016, the Company generated operating losses in its AMS segment while DTX realized operating income for the first time in 2015 and was profitable again in 2016 and 2017. The Company's ability for generating profits from these initiatives will depend on its products gaining market acceptance among customers, which cannot be guaranteed. The degree of market acceptance of any new products the Company develops will depend on a number of factors, including:

- the Company's ability to successfully develop its technologies and products to include the capabilities the Company intends;
- the Company's ability to accurately assess the functions and features customers desire;
- the perceived effectiveness and price of the Company's products compared to alternative products and technologies;
- the development of new products and technologies by current competitors or new competitors that might enter the Company's markets; and
- the strength of the Company's marketing and distribution functions.

If new products that the Company develops do not have the capabilities the Company expects or fail to achieve an adequate level of acceptance by customers for any reason, then the Company's AMS and DTX business units could fail to generate the revenues the Company expects and may not become profitable or sustain profitability.

If the Company's new products and technologies do not achieve market acceptance, the Company will not realize a return on its investments in its new business initiatives.

The Company has invested, and plans to continue to invest, significant resources in its research and development efforts to develop technology for its AMS and DTX business units. The Company spent 4.0% of sales, or \$689,000, on research and development in 2017 and 3.7% of sales, or \$647,000, in 2016. A substantial portion of these investments was in the Company's AMS and DTX initiatives. The Company plans to continue to invest significant resources in research and development on these initiatives for the foreseeable future. The Company believes successful

execution of these initiatives is important for its ability to grow its revenues and profits. However, if the Company fails to generate its projected revenues in these business units, the Company's investments in these areas would not generate the profits the Company expects and its results of operations, financial condition and prospects would be materially and adversely affected.

Adverse changes to global economic conditions generally, and to the aerospace and automotive industries in particular, may harm the Company's business.

The prospects for economic growth in the United States and other countries remain uncertain and major economies where the Company conducts business could continue or return to recessionary conditions. Economic concerns and issues such as reduced access to capital for businesses may cause the Company's customers to delay or reduce purchases of the Company's products. Given the continued uncertainty concerning the global economy, the Company also faces risks that may arise from financial difficulties experienced by suppliers and customers, such as an inability to collect receivables or the continued operation of suppliers.

The Company's AMS segment focuses primarily on customers in the aerospace industry, and its DTX segment focuses primarily on customers in the automotive industry. The aerospace and automotive industries have experienced volatility in prior years in a manner similar to or greater than the global economy generally. If either or both these industries experiences difficulties that reduce demand for their products generally, the Company's results of operations, financial condition and prospects would suffer.

The Company faces significant competition and expects to face increasing competition in many aspects of its businesses, which could cause operating results to suffer.

The Company operates in highly competitive industries that experience rapid technological and market developments, changes in customer needs, and frequent product introductions and improvements, particularly with respect to the AMS and DTX businesses. If the Company is unable to anticipate and respond to these developments, its products or technologies could become uncompetitive or obsolete. Most of the Company's competitors in the AMS and DTX fields are larger and better capitalized than the Company with longer operating histories. These advantages could allow the Company's competitors to invest more resources in research and development and sales and marketing than the Company, which could make the competitive products more attractive or better known to consumers than the Company's products. In addition, because there is potential for rapid technological change in fields in which the Company operates, the Company could face competition from new sources in the future that customers find more attractive.

The Company also could face increased competition in its traditional Domestic and IKONICS Imaging units. Capital costs for machinery necessary to operate in these industries have decreased in recent years, increasing the possibility that the Company will face new competitors. An increase in the amount of competition the Company faces, or a loss of competitiveness in any of the Company's business units for any reason, could adversely affect its revenues and gross margins.

The Company's failure to comply with environmental laws and regulations could harm its business and results of operations.

The manufacturing of the Company's products requires the use of hazardous materials that are subject to a broad array of environmental laws and regulations. The Company's failure to comply with these laws or regulations could result in:

- regulatory penalties, fines and legal liabilities;
- suspension of production;
- alteration of manufacturing processes; and
- restrictions on the Company's operations or sales.

The Company's failure to manage the use, transportation, emissions, discharge, storage, recycling or disposal of hazardous materials could lead to increased costs or future liabilities. Environmental laws and regulations also could require the Company to acquire pollution abatement or remediation equipment, modify product designs or incur other expenses.

Third parties may claim the Company infringes their intellectual property rights, which could harm the Company's business.

The Company may face claims that it infringes other parties' intellectual rights. Regardless of a claim's merit, claims that the Company's products or processes infringe the intellectual property rights of others could cause the Company to incur large costs to respond to, defend, and resolve the claims, and they may divert the efforts and attention of management and technical personnel. As a result of any intellectual property rights infringement claims, the Company could be required to:

- pay infringement claims;
- stop manufacturing, using, or selling products or technology subject to infringement claims;
- develop other products or technology not subject to infringement claims, which could be time-consuming, costly or impossible; or
- license technology from the party claiming infringement, which license may not be available on commercially reasonable terms, if at all.

These actions could harm the Company's competitive position, result in additional expenses, or require the Company to impair its assets. If the Company alters or stops production of affected items, its ability to generate revenue could be harmed.

The Company may be unable to enforce or protect its intellectual property rights, which may harm its ability to compete and may harm its business.

The Company's ability to enforce its patents, trademarks and other intellectual property rights is subject to general litigation risks, as well as uncertainty as to the enforceability of the Company's intellectual property rights in various countries. If the Company seeks to enforce its rights, it could become subject to claims that its intellectual property rights are invalid, not enforceable, or licensed to the opposing party. The Company's assertion of intellectual property rights also could result in the other party seeking to assert claims against the Company, which could harm the Company's business. The Company's inability to enforce its intellectual property rights for any reason could harm its competitive position and business.

If the Company is unable to protect the confidentiality of its proprietary information and know-how, the value of its technology could be adversely affected.

In addition to patented technology, the Company relies on unpatented proprietary technology, trade secrets, processes and know-how. The Company generally seeks to protect this information by confidentiality agreements with employees, consultants, advisors and third parties. These agreements may be breached, and the Company may not have adequate remedies for any such breach. In addition, the Company's trade secrets may otherwise become known or be independently developed by competitors. To the extent that the Company's employees, consultants or contractors use intellectual property owned by others in their work for the Company, disputes may arise as to the rights in related or resulting know-how and inventions.

The Company operates a global business that exposes it to additional risks.

The Company operates throughout the world, including in the United States, Europe and China. These international operations create a variety of risks and uncertainties, including:

- rapid changes in government, economic and political policies and conditions, political or civil unrest or instability, terrorism or epidemics;

- fluctuations in foreign currency exchange rates;
- compliance with and changes in foreign laws and regulations, as well as U.S. laws affecting the activities of U.S. companies abroad, including the Foreign Corrupt Practices Act of 1977, as amended (the “FCPA”);
- different, complex and changing laws governing intellectual property rights, sometimes affording companies lesser protection in certain areas;
- longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- protectionist laws and business practices that favor local producers; and
- potentially adverse tax consequences, including the complexities of foreign value added tax systems and restrictions on the repatriation of earnings.

The occurrence of any one of these risks could negatively affect the Company’s international business and, consequently, its results of operations generally.

The Company faces risks related to sales through distributors and other third parties.

During 2017, a significant portion of the Company’s sales, including nearly all sales of its Domestic products and nearly all of its International sales, were conducted through third parties. Using third parties for distribution exposes the Company to many risks, including competitive pressure, concentration, credit risk and compliance risks. Distributors may sell products that compete with the Company’s products, and the loss of a distributor could reduce the Company’s revenue. Distributors may face financial difficulties, including bankruptcy, which could harm the Company’s collection of accounts receivable and financial results. Violations of the FCPA or similar laws by distributors or other third-party intermediaries could have a material impact on the Company’s business. Failing to manage risks related to the Company’s use of distributors may reduce sales, increase expenses, and weaken its competitive position.

Increases in prices and declines in the availability of raw materials could negatively impact the Company’s financial results.

Certain raw materials needed to manufacture products are obtained from a limited number of suppliers and many of the raw materials are petroleum-based. Under normal market conditions, these raw materials are generally available on the open market from a variety of producers. While alternate supplies of most key raw materials are available, supplier production outages may lead to strained supply-demand situations for certain raw materials. The substitution of key raw materials could require the Company to identify new supply sources, or reformulate and retest products or processes. From time to time, the prices and availability of these raw materials may fluctuate, which could impair the Company’s ability to procure necessary materials, or increase the cost of manufacturing products. If the prices of raw materials increase in a short period of time, the Company may be unable to pass these increases on to its customers in a timely manner or at all, which could reduce its gross margins. Like most companies in the Company’s industries, the Company does not have long-term supply contracts for most of its key raw materials, which exacerbates the foregoing risks to the Company.

If any of the Company’s present single or limited source suppliers become unavailable or inadequate, its customer relationships, results of operations and financial condition may be adversely affected.

The Company acquires certain of its materials that are critical to its operations from a limited number of third parties. Should any of the Company’s current single or limited source suppliers become unavailable or inadequate, or impose terms unacceptable to the Company such as increased pricing terms, the Company could be required to spend a significant amount of time and expense to develop alternate sources of supply, and may not be successful in doing so on acceptable terms or at all. If the Company is unable to find a suitable supplier for a particular material, it could be required to modify its existing business processes or offerings to accommodate the situation. As a result, the loss of a single or limited source supplier could adversely affect the Company’s relationship with its customers and its results of operations and financial condition.

The Company depends on one manufacturer to make and sell DTX printers. If the manufacturer ceased to make or sell DTX printers, or failed to meet quality standards, the Company's financial results and prospects would be adversely affected.

The Company relies on one company to manufacture and sell DTX printers. If the manufacturer ceased to produce or devote resources to selling DTX printers, due to a change in company strategy, to focus on alternative initiatives, or for any other reason, the Company would need to find an alternative manufacturer and seller of DTX printers. Finding an alternative manufacturer and seller of DTX printers could result in additional costs and delays in growing the Company's DTX business unit, which would adversely affect the Company's financial results and prospects.

In addition, if these manufacturers failed to produce DTX printers that satisfy the Company's quality standards, the Company's reputation with end users could be harmed and the Company could be forced to find a new manufacturer. Either of these results also would harm the Company's business and prospects.

The inability to attract and retain qualified personnel could adversely impact the Company's business.

Sustaining and growing the Company's business depends on the recruitment, development and retention of qualified employees, including management and research and development personnel. The inability to recruit and retain key personnel or the unexpected loss of key personnel may adversely affect the Company's operations.

An active trading market for the Company's shares of common stock may not develop.

The Company's common stock has been listed for trading on the Nasdaq Capital Market since 1999 and persistently has experienced limited trading volume. There can be no assurance that an active public market for the Company's shares will develop or be sustained. The lack of an active trading market could adversely affect the price and liquidity of the Company's common stock.

The Company's directors and officers own a large percentage of the Company's common stock, which may allow them to collectively exert significant influence over substantially all matters requiring shareholder approval.

As of December 31, 2017, the Company's directors and officers collectively beneficially owned approximately 14.0% of its common stock outstanding as of that date. As a result, the Company's directors and officers could exert significant influence over all matters requiring a shareholder vote, including the election of directors, amendments to the Company's articles of incorporation, and extraordinary transactions such as mergers or going private transactions. These ownership positions may have the effect of delaying, deterring or preventing a change in control or a change in the composition of the Company's board of directors. In addition, substantial sales of shares beneficially owned by our directors or officers could be viewed negatively by third parties and have a negative impact on the Company's stock price.

The price of the Company's common stock may fluctuate significantly.

The price of the Company's common stock has, and could continue to, fluctuate substantially in a short period of time. The price of the Company's common stock could vary for many reasons, including the following:

- future announcements concerning the Company or its competitors;
- introduction of new products by the Company or its competitors, or the failure of the Company's new products to meet expectations;
- the commencement of, or developments to, litigation involving the Company;
- quarterly variations in operating results, which the Company has experienced in the past and expects to experience in the future;
- business acquisitions or divestitures; or

- changes to the global economy in general, and the aerospace and automotive markets in particular.

In addition, stock markets in general have experienced price and volume fluctuations in recent years, fluctuations that sometimes have been unrelated to the operating performance of the affected companies. These broad market fluctuations may adversely affect the market price of the Company's common stock. The market price of the Company's common stock could decline below its current price and the market price of the Company's shares may fluctuate significantly in the future. These fluctuations may be unrelated to the Company's performance.

The terms of our financing agreement contain certain financial ratio covenants that may impair our ability to conduct our business.

On April 1, 2016, we entered into a financing agreement with the Duluth Economic Development Authority and Wells Fargo Bank, N.A. to borrow \$3.4 million. The proceeds from the loan were used to finance the construction of a 27,300-square foot building, as well as related equipment for use in our manufacture of sound deadening technology used in the aerospace industry and products consisting of etched composites, ceramics, glass and silicon wafers, to be located in Duluth, Minnesota. We are subject to certain customary covenants set forth in the associated covenant agreement, including a requirement that we maintain a debt service coverage ratio as of the end of each calendar quarter of not less than 1.25 to 1.00 on a rolling four-quarter basis. In the event of a breach of a covenant, we would need to obtain a waiver from the lender or the lender may cancel the financing agreement and accelerate the full amount of outstanding indebtedness. We were in compliance with the covenants, including the debt service ratio covenant, as of December 31, 2017, but our ability to comply with these covenants in the future will depend on future operating performance and we may not meet them. In the event that we fall out of compliance with these covenants and we are unable to obtain a waiver and the indebtedness is accelerated, it would have an adverse effect on our financial condition and future operating performance and could limit our ability to invest in other business activities.

We heavily rely on our information technology systems and are vulnerable to damage and interruption.

We rely on our information technology systems and infrastructure to process transactions and manage our business, including maintaining employee, client and supplier information. We have also engaged third parties, including cloud providers, to store, transfer and process data. Our information technology systems, as well as the systems of our customers, suppliers and other partners, are vulnerable to outages and an increasing risk of deliberate intrusions to gain access to and exploit company sensitive information. Similarly, data security breaches by employees and others with or without permitted access to our systems pose a risk that sensitive data may be exposed to unauthorized persons or to the public. We may be unable to prevent outages or security breaches in our systems that could adversely affect our results of operations and cause reputational harm.

The Company's operating results and financial condition may fluctuate on a quarterly and annual basis.

The Company's operating results and financial condition may fluctuate from quarter to quarter and year to year, and could vary due to a number of factors, some of which are outside of the Company's control. In addition, the Company's actual or projected operating results may fail to match its past performance. The Company's operating results and financial condition may fluctuate due to a number of factors, including those listed below and those identified throughout this "Risk Factors" section:

- the failure of the Company's new products to meet expectations;
- changes to the costs of raw materials, especially petroleum-based materials;
- the entry of new competitors into the Company's markets whether by established companies or by new companies;
- the geographic distribution of the Company's sales;
- changes in customer preferences or needs;
- changes in the amount that the Company invests to develop or acquire new technologies;

- delays between the Company’s expenditures to develop new technologies and products and the generation of sales related thereto;
- changes in the Company’s pricing policies or those of its competitors;
- changes in accounting rules and tax and other laws; and
- general economic and industry conditions that affect customer demand and product development trends.

Due to all of the foregoing factors and the other risks discussed in this “Risk Factors” section, you should not rely on quarter-to-quarter or year-to-year comparisons of the Company’s operating results as an indicator of future performance.

Item 1B. Unresolved Staff Comments

None

Item 2. Property

The Company primarily conducts its operations in Duluth, Minnesota. The administrative, sales, research and development, quality and most of the manufacturing activities are housed in a 60,000 square-foot, four-story building, including a basement level. The building is approximately seventy years old and has been maintained in good condition. The Company also utilizes a 5,625 square-foot warehouse adjacent to the existing plant building that was constructed in 1997. These facilities are owned by the Company with no existing liens or leases. The Company also owns an approximately 11-acre property with a 62,300 square-foot manufacturing and warehouse facility. The 62,300 square-foot facility is comprised of a 35,000 square-foot warehousing and manufacturing facility constructed in 2008 and a 27,300 square-foot expansion completed in 2016 to accommodate the Company’s AMS business. The entire facility on the 11-acre property is collateral on the Company’s \$3.4 million loan.

Item 3. Legal Proceedings

None.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's Common Stock is traded on the Nasdaq Capital Market under the symbol IKNX. The following table sets forth, for the fiscal quarters indicated, the high and low sales prices for the Company's Common Stock as reported on the Nasdaq Capital Market for the periods indicated.

	<u>High</u>	<u>Low</u>
Fiscal Year Ended December 31, 2017:		
First Quarter	\$ 12.00	\$ 9.50
Second Quarter	10.14	7.40
Third Quarter	9.39	8.20
Fourth Quarter	8.80	7.34
Fiscal Year Ended December 31, 2016:		
First Quarter	\$ 12.33	\$ 10.29
Second Quarter	11.95	10.20
Third Quarter	13.95	10.25
Fourth Quarter	12.00	10.47

As of February 23, 2018, the Company had 534 shareholders. The Company has not declared cash dividends in the past two years and does not currently have plans to pay any cash dividends in the future. Any future declaration and payment of dividends is within the sole discretion of the Company's board of directors.

The Company repurchased shares as indicated in the table below during the fourth quarter of 2017⁽¹⁾:

	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under The Plans or Programs
Oct. 1, 2017 through Oct. 31, 2017	—	\$ —	—	75,000
Nov. 1, 2017 through Nov 30, 2017	7,649	\$ 7.83	7,649	67,351
Dec. 1, 2017 through Dec. 31, 2017	851	\$ 8.00	851	66,550
Total	<u>35,450</u>		<u>35,450</u>	

- (1) In prior years, the Company's board of directors had authorized the repurchase of up to 250,000 shares of common stock. A total of 219,589 shares were repurchased under this program including 1,950 shares repurchased during the second quarter of 2017. As of August 2, 2017, the plan allowed for an additional 30,411 shares to be repurchased. On August 3, 2017, the Company's board of directors approved a new repurchase authorization for up to 100,000 shares of the Company's common stock, which replaced all prior authorizations. Shares repurchased under this new authorization may be made through open market and privately negotiated transactions from time to time. The new share repurchase authorization does not have an expiration date.

Item 6. Selected Financial Data

Not applicable

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following management discussion and analysis focuses on those factors that had a material effect on the Company's financial results of operations and financial condition during 2017 and 2016 and should be read in conjunction with the Company's audited financial statements and notes thereto for the years ended December 31, 2017 and 2016, included herein.

Critical Accounting Policies and Estimates

The Company prepares its financial statements in conformity with accounting principles generally accepted in the United States of America. Therefore, the Company is required to make certain estimates, judgments and assumptions that the Company believes are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. The accounting policies and estimates which IKONICS believes are the most critical to aid in fully understanding and evaluating its reported financial results include the following:

Revenue Recognition. The Company recognizes revenue on sales of products when title passes, which can occur at the time of shipment, or when the goods arrive at the customer location depending on the agreement with the customer. The Company sells its products to both distributors and end-users. Sales to distributors and end-users are recorded based upon the criteria governed by the sales, delivery, and payment terms stated on the invoices from the Company to the purchaser. In addition to transfer of title / risk of loss, all revenue is recorded in accordance with the criteria outlined within SAB 104 and FASB ASC 605, Revenue Recognition:

- (a) persuasive evidence of an arrangement (principally in the form of customer sales orders and the Company's sales invoices);
- (b) delivery and performance (evidenced by proof of delivery, e.g. the shipment of film and substrates with bill of lading used for proof of delivery for FOB shipping point terms, and the carrier booking confirmation report used for FOB destination terms). Once the finished product is shipped and physically delivered under the terms of the invoice and sales order, the Company has no additional performance or service obligations to complete;
- (c) a fixed and determinable sales price (the Company's pricing is established and is not based on variable terms, as evidenced in either the Company's invoices or the limited number of distribution agreements; the Company rarely grants extended payment terms and has no history of concessions); and
- (d) a reasonable likelihood of payment (the Company's terms are standard, and the Company does not have a substantial history of customer defaults or non-payment).

Sales are reported on a net basis by deducting credits, estimated normal returns and discounts. The Company's return policy does not vary by geography. The customer has no rotation or price protection rights and the Company is not under a warranty obligation. Freight billed to customers is included in sales. Shipping costs are included in cost of goods sold.

Trade Receivables. The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current credit worthiness, as determined by review of the current credit information. The Company continuously monitors collections and payments from its customers and maintains a provision for estimated credit losses based upon historical experience and any specific customer collection issues that have been identified. While such credit losses have historically been within expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same collection history that has occurred in the past. The general payment terms are net 30-45 days for domestic customers and net 30-90 days for foreign customers. A small percentage of the trade receivables balance is denominated in a foreign currency with no concentration in any given country. At the end of each reporting period, the Company analyzes the receivable balance for customers paying in a foreign currency. These balances are adjusted to each quarter or year-end spot rate. The Company also maintains a provision based upon historical experience and any specifically identified issues for any customer related returns, refunds or credits.

Inventories. Inventories are valued at the lower of cost or market value using the last in, first out (LIFO) method. The Company monitors its inventory for obsolescence and records reductions from cost when required.

Income Taxes. Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are

recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. The Tax Cut and Jobs Act of 2017 (the "Tax Reform Act") was enacted December 22, 2017. This legislation makes significant changes in U.S. tax law including a reduction in the corporate tax rates, changes to net operating loss carryforwards and carrybacks and a repeal of the corporate alternative minimum tax. The legislation reduced the U.S. corporate tax rate from the current rate of 34% and 35% to 21%. As a result of the enacted law, the Company was required to revalue deferred tax assets and liabilities at the newly enacted rate. This revaluation resulted in a benefit of \$115,000 to income tax expense in continuing operations and a corresponding reduction in the deferred tax liability. The other provisions of the Tax Reform Act did not have a material impact on the 2017 consolidated financial statements.

Results of Operations

Year Ended December 31, 2017 Compared to Year Ended December 31, 2016

Sales. Sales decreased 1.9% in 2017 to \$17.2 million, compared to \$17.6 million in 2016. A more competitive market for artwork film sales along with overall soft market conditions resulted in a decrease in Domestic sales from \$7.4 million in 2016 to \$6.9 million in 2017. Compared to 2016, IKONICS Imaging sales decreased by \$231,000 to \$4.0 million in 2017 as sales were negatively affected by some customers moving to competing technologies. The IKONICS Imaging sales variance was also impacted by a large initial order from a new customer received in 2016. Partially offsetting these sales decreases in 2017, IKONICS Imaging realized sales of \$258,000 for its newly introduced SubTHAT!TM film. AMS sales decreased by \$296,000, or 28.4%, in 2017 versus 2016 due to the temporary decrease in orders from AMS's largest customer during the second quarter of 2017. Beginning in the third quarter of 2017, the customer resumed its normal order pattern, which is expected to continue in 2018. Partially offsetting these sales decreases was a \$413,000, or 101.9% increase in DTX due to the sale of two DTX printers and improved consumable sales. Export sales also realized a \$214,000, or 4.8%, sales increase in 2017 compared to 2016 due to improved sales to Asia.

Gross Profit. Gross profit was \$5.7 million, or 33.2% of sales, in 2017 compared to \$6.2 million, or 35.5% of sales, in 2016. The gross profit as a percentage of sales decreased due to lower sale volumes and a less favorable sales mix. Low margin Export sales comprised 27.4% of total 2017 sales compared to 25.7% of total sales in 2016 while higher margin IKONICS Imaging sales comprised 23.3% of total sales in 2017 versus 24.2% of total sales in 2016. The gross margin percentage in 2017 was also unfavorably impacted by the sale of two low margin DTX printers and the temporary decrease in AMS sales in 2017.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were \$5.5 million, or 31.9% of sales, in 2017 compared to \$5.6 million, or 31.9% of sales, in 2016. The decrease in selling, general and administrative expenses reflects lower health insurance expenses in 2017. IKONICS utilizes a self-funded medical insurance plan and can experience fluctuations in medical insurance costs. The Company mitigates part of the risk under this self-funded plan by purchasing both specific and aggregate stop-loss insurance coverage. The decrease in selling, general and administrative expenses also reflects lower travel expenses. These expense decreases were partially offset by increased trade show expenses along with higher international sales consulting expenses.

Research and Development Expenses. Research and development expenses in 2017 were \$689,000, or 4.0% of sales, versus \$647,000, or 3.7% of sales in 2016. The increase in expenses in 2017 was due to patent-related legal expenses along with increased production trial expenses.

Income Taxes. During 2017, the Company realized an income tax benefit of \$298,000, or an effective rate of 56.8%, compared to income tax benefit of \$4,000, or an effective rate of 5.8%, for the same period in 2016. The increase to income tax benefit in 2017 from 2016 is primarily due to a benefit of \$115,000 related to the favorable impact of a revaluation of the Company's deferred tax liability as a result of the Tax Reform Act as well as a higher pre-tax book loss generated in 2017 compared to the pre-tax book loss generated in 2016. Additionally, differences between effective tax rate and the statutory tax rate are related to credits for research and development, and other non-deductible items.

Liquidity and Capital Resources

Outside of the 2016 building expansion, for which \$3.4 million in financing was obtained, the Company has financed its operations principally with funds generated from operations. These funds have been sufficient to cover the Company's normal operating expenditures, annual capital requirements, and research and development expenditures.

Cash and cash equivalents were \$930,000 and \$1.0 million at December 31, 2017 and 2016, respectively. In addition to its cash, the Company held \$2.9 million and \$3.2 million of short-term investments as of December 31, 2017 and 2016, respectively. The Company generated \$205,000 in cash from operating activities during 2017, compared to generating \$917,000 of cash from operating activities in 2016. Cash provided by operating activities is primarily the result of the net loss adjusted for non-cash depreciation and amortization, deferred taxes, and certain changes in working capital components discussed in the following paragraph.

During 2017, improved collections resulted in a \$146,000 trade receivables decrease. Inventories increased by \$100,000 related to an increase in finished goods inventories compared to 2016. Accounts payable decreased from 2016 to 2017 by \$409,000 due to the timing of payments to and purchases from vendors, mainly related to raw materials. Prepaid expenses and other assets decreased \$194,000 from 2016 to 2017. The decrease is mainly related to 2016 prepayments on equipment being manufactured that was sold in 2017. Compared to 2016, accrued expenses decreased \$33,000 reflecting the timing of compensation payments. Income taxes receivables decreased \$64,000 due to the timing of estimated 2017 tax payments compared to the calculated 2017 tax liability.

During 2016, inventories decreased by \$134,000 related to a decrease in raw material inventories compared to 2015. The timing of collections resulted in a \$171,000 trade receivables increase in 2016 versus 2015. Accounts payable increased from 2015 to 2016 by \$310,000 due to the timing of payments to and purchases from vendors. Prepaid expenses and other assets increased \$276,000 from 2015 to 2016. The increase is mainly related to prepayments on equipment manufactured in 2016 that were completed and sold in 2017. Compared to 2015, accrued expenses increased \$74,000 reflecting the timing of compensation payments and an increase in the accrual for medical expenses. Income taxes receivable decreased \$37,000 due to the timing of estimated 2016 tax payments compared to the calculated 2016 tax liability.

During 2017, cash provided by investing activities was \$115,000. The Company purchased 16 certificates of deposits totaling \$3.9 million. Eighteen certificates of deposits totaling \$4.2 million matured during 2017. The Company's purchases of property and equipment of \$230,000 in 2017 were mainly for improvements to production and process capabilities and two vehicles. Also, during 2017, the Company incurred \$39,000 in patent application costs that the Company has recorded as an asset and will amortize upon successful completion of the application process. In addition, the Company sold three vehicles for \$33,000.

During 2016, cash used in investing activities was \$5.3 million. The Company purchased 19 certificates of deposits totaling \$4.4 million. Five certificates of deposits totaling \$1.1 million matured during 2016. The Company's cash purchases of property and equipment were \$2.1 million in 2016. Total building expansion expenditures for 2016 were \$1,393,000. Expenditures on the new ERP system in 2016 were \$281,000. The remaining capital expenditures were mainly for upgrades to improve AMS production and process capabilities. Also during 2016, the Company incurred \$27,000 in patent application costs that the Company records as an asset and amortizes upon successful completion of the application process. In addition, the Company sold equipment for \$21,000.

Related to the Company's loan, the Company made principal payments of \$140,000 in 2017. During 2017, the Company received \$2,000 from financing activities from the issuance of 250 shares of common stock due to the exercise of stock options, while the Company repurchased 35,450 shares of its own stock for \$300,000.

During 2016, the Company received \$3.2 million from financing activities. The Company secured a loan of \$3.4 million in which the proceeds were used to finance the expansion of its AMS facility. Related to securing the loan, the Company paid \$139,000 in debt issuance costs and made principal payments of \$79,000. During 2016, the Company received \$4,000 from the issuance of 500 shares of common stock pursuant to the exercise of stock options.

On April 1, 2016, the Company entered into a financing agreement to borrow \$3.4 million. The proceeds from the loan were used to finance the construction of a 27,300-square foot building, as well as related equipment for use in the Company's manufacture of sound deadening technology used in the aerospace industry and products consisting of

etched composites, ceramics, glass and silicon wafers, to be located in Duluth, Minnesota. The Loan requires monthly payments of approximately \$18,000, including interest. The Loan bears interest at a rate of 2.14% per year, subject to change based upon changes to the maximum federal corporate tax rate, payable monthly, and matures on April 1, 2041. The Loan is subject to mandatory purchase provisions, under which any owners of the Bonds (the "Owners") may tender the Bonds to the Issuer on April 1, 2021, which would result in the Company repaying the outstanding loan principal and any outstanding accrued and unpaid interest to the Issuer at that time. If in the event the Bonds are not repurchased on April 1, 2021, the Bonds shall be subject to the interest rate and redemption provisions set forth in the associated covenant agreement. Including debt costs of approximately \$139,000, the Loan's effective annual interest rate was 2.77% at December 31, 2017. As a result of the Tax Reform Act described above, the Company estimates the future effective interest rate will be approximately 3.23% beginning in March 2018, resulting in an approximate \$15,000 increase in interest payments annually. The Company is subject to certain customary covenants set forth in the associated covenant agreement, including a requirement that the Company maintain a debt service coverage ratio as of the end of each calendar quarter of not less than 1.25 to 1.00 on a rolling four-quarter basis. The Company was in compliance with the required debt service coverage ratio as of December 31, 2017 and 2016.

A bank line of credit exists providing for borrowings of up to \$2,050,000 and expires on June 30, 2019. The line of credit is collateralized by the Company's assets and bears interest at 1.8 percentage points over the 30-day LIBOR rate. The Company did not utilize this line of credit during 2017 or 2016, and there were no borrowings outstanding as of December 31, 2017 and 2016. There are no financial covenants related to the line of credit.

The Company believes that current financial resources, its line of credit, cash generated from operations and secured through debt financing, and short term investments, along with the Company's capacity for additional debt and/or equity financing will be sufficient to fund current and anticipated business operations. The Company also believes that it is unlikely that a decrease in demand for the Company's products would impair the Company's ability to fund operations given its excess cash and available line of credit.

Capital Expenditures

In 2017, the Company incurred \$230,000 of capital expenditures which were mainly for improvements to production and process capabilities and two vehicles. In 2016, the Company incurred \$1.7 million of capital expenditures. A majority of the expenditures were related to the AMS building expansion. The remaining capital expenditures were for upgrades to improve AMS production and process capabilities, as well as for a new ERP system.

The Company expects capital expenditures in 2018 of approximately \$658,000. The planned expenditures primarily will be to upgrade the heating, cooling and ventilation system at the Company's main facility and manufacturing equipment to improve processes and capabilities. These commitments are expected to be funded with cash generated from operating activities.

International Activity

The Company markets its products in numerous countries in various regions of the world, including North America, Europe, Latin America, and Asia. The Company's 2017 foreign sales of \$5.4 million were approximately 30.5% of total sales, compared to the 2016 foreign sales of \$4.9 million, which were 28.0% of total sales. The Company realized an increase in foreign sales due to the sale of two DTX printers into Europe and improved consumable sales to Asia.

The Company's foreign transactions are primarily negotiated, invoiced and paid in U.S. dollars, though a portion is transacted in Euros. IKONICS has not implemented an economic hedging strategy to reduce the risk of foreign currency translation exposures, which management does not believe to be significant based on the scope and geographic diversity of the Company's foreign operations. Furthermore, the impact of foreign exchange on the Company's balance sheet and operating results was not material in either 2017 or 2016.

Future Outlook

IKONICS has spent an average of approximately 4.0% of annual sales in research and development and has made capital expenditures related to new products and programs. The Company plans to maintain its efforts in these

areas to expedite internal product development as well as to form technological alliances with outside entities to commercialize new product opportunities.

The Company continues to make progress on its AMS business initiative. Although AMS experienced a short-term drop in sales during 2017 due to temporary inventory overstocking by a major customer, these sales have returned to expected levels, and the Company anticipates continued growth over the long term. The Company has two long-term sales agreements in place for its technology with major aerospace companies and is negotiating a third. In anticipation of this growing business, the Company increased its AMS capacity with a 27,300 square foot expansion at its Morgan Park site in 2016.

The Company is also continuing to pursue DTX-related business initiatives and expects increased consumable sales as a result of the sale of two DTX printers in 2017. In addition to making efforts towards growing the inkjet technology business, the Company offers a range of products for creating texture surfaces and has introduced a fluid for use in prototyping. The Company is currently working on production improvements to enhance its customer offerings. The Company has been awarded European, Japanese, and United States patents on its DTX technologies. The Company has also modified its DTX technology to facilitate entry into the market for prototyping.

Both the Domestic and IKONICS Imaging units remain profitable in mature markets. Although these business units require aggressive strategies to grow market share, both are developing new products and business relationships that we believe will contribute to growth. In October 2017, the Company introduced SubTHAT!TM, a patent-pending product for the dye-sublimation market. Response to SubTHAT!TM has been very encouraging, with the Company realizing SubTHAT!TM sales of \$258,000 in the fourth quarter of 2017. In addition to its traditional emphasis on domestic markets, the Company will continue efforts to grow its business internationally by attempting to develop new markets and expanding market share where it has already established a presence. However, the strong U.S. dollar has made this challenging.

Other future activities undertaken to expand the Company's business may include acquisitions, building improvements, equipment additions, new product development and marketing opportunities.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09 supersedes the revenue recognition requirements in *Revenue Recognition (Topic 605)*, and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers: Deferral of the Effective Date*, which defers the adoption of ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The standard permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method). The standard also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract.

The Company will adopt the provisions of ASU 2014-09 on January 1, 2018 using the modified retrospective method. While most of the Company's revenue is contracted with customers through one-time purchase orders and short-term contracts, the Company does have long-term contracts with certain customers. The Company is nearly complete with its evaluation of the effect of adoption on its financial statements, and will expand its financial statement disclosures in future periods in order to comply with the new standard. For the revenue streams assessed, the Company does not anticipate any adjustments regarding the timing of recognizing revenue as a result of the adoption. The

Company does not incur upfront costs to obtain a contract and, upon adoption, the Company will elect to treat delivery costs as a fulfillment activity that are expensed as incurred.

During February 2016, the FASB issued ASU No. 2016-02, *Leases*. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing all lease transactions (with terms in excess of 12 months) on the balance sheet as a lease liability and a right-of-use asset (as defined). ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with earlier application permitted. Upon adoption, the lessee will apply the new standard retrospectively to all periods presented or retrospectively using a cumulative effect adjustment in the year of adoption. The Company does not expect the adoption of ASU No. 2016-02 to have a material impact on its financial statements.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation—Stock Compensation (Topic 718)*. This standard makes several modifications to Topic 718 related to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. ASU 2016-09 also clarifies the statement of cash flows presentation for certain components of share-based awards. The standard is effective for interim and annual reporting periods beginning after December 15, 2016, although early adoption is permitted. The Company adopted ASU No. 2016-09 in 2017 with minimal impact on the financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable

Item 8. Financial Statements

Report of Independent Registered Public Accounting Firm

To the Stockholders and the Board of Directors of IKONICS Corporation

Opinion on the Financial Statements

We have audited the accompanying balance sheets of IKONICS Corporation (the Company) as of December 31, 2017 and 2016, the related statements of operations, stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ RSM US LLP

We have served as the Company's auditor since 2002.

Duluth, Minnesota
March 2, 2018

IKONICS CORPORATION
BALANCE SHEETS
DECEMBER 31, 2017 AND 2016

	<u>December 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 929,700	\$ 1,048,713
Short-term investments	2,895,000	3,246,000
Trade receivables, less allowances of \$53,000 in 2017 and \$54,000 in 2016	2,190,260	2,336,501
Inventories	2,086,065	1,986,172
Prepaid expenses and other assets	168,242	361,905
Income taxes receivable	2,116	66,181
Total current assets	<u>8,271,383</u>	<u>9,045,472</u>
PROPERTY, PLANT, AND EQUIPMENT, at cost:		
Land and building	9,207,790	9,189,743
Machinery and equipment	4,968,595	4,884,814
Office equipment	1,573,191	1,566,856
Vehicles	245,679	272,144
	<u>15,995,255</u>	<u>15,913,557</u>
Less accumulated depreciation	(7,693,594)	(7,001,162)
Total property, plant, and equipment, at cost	<u>8,301,661</u>	<u>8,912,395</u>
INTANGIBLE ASSETS, less accumulated amortization of \$174,991 in 2017 and \$149,072 in 2016	351,186	338,127
Total assets	<u>\$ 16,924,230</u>	<u>\$ 18,295,994</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current portion of long-term debt, net	\$ 130,899	\$ 127,303
Accounts payable	321,860	730,386
Accrued compensation	360,554	388,600
Other accrued liabilities	62,468	67,088
Total current liabilities	<u>875,781</u>	<u>1,313,377</u>
LONG-TERM LIABILITIES		
Long-term debt, less current portion, net	2,946,518	3,077,457
Deferred income taxes	144,000	446,000
Total long-term liabilities	<u>3,090,518</u>	<u>3,523,457</u>
Total liabilities	<u>3,966,299</u>	<u>4,836,834</u>
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock, par value \$.10 per share; authorized 250,000 shares; none issued	—	—
Common stock, par value \$.10 per share; authorized 4,750,000 shares; issued and outstanding 1,983,553 shares in 2017 and 2,018,753 shares in 2016	198,355	201,875
Additional paid-in capital	2,709,390	2,732,006
Retained earnings	10,050,186	10,525,279
Total stockholders' equity	<u>12,957,931</u>	<u>13,459,160</u>
Total liabilities and stockholders' equity	<u>\$ 16,924,230</u>	<u>\$ 18,295,994</u>

See notes to financial statements.

IKONICS CORPORATION

**STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2017 AND 2016**

	Year Ended December 31,	
	<u>2017</u>	<u>2016</u>
NET SALES	\$ 17,243,244	\$ 17,569,901
COST OF GOODS SOLD	<u>11,512,699</u>	<u>11,332,991</u>
GROSS PROFIT	5,730,545	6,236,910
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	5,506,466	5,611,849
RESEARCH AND DEVELOPMENT EXPENSES	<u>688,688</u>	<u>647,065</u>
LOSS FROM OPERATIONS	(464,609)	(22,004)
INTEREST EXPENSE	(83,080)	(58,222)
OTHER	<u>23,542</u>	<u>11,165</u>
LOSS BEFORE INCOME TAXES	(524,147)	(69,061)
INCOME TAX BENEFIT	<u>(298,000)</u>	<u>(4,000)</u>
NET LOSS	<u>\$ (226,147)</u>	<u>\$ (65,061)</u>
LOSS PER COMMON SHARE:		
Basic	<u>\$ (0.11)</u>	<u>\$ (0.03)</u>
Diluted	<u>\$ (0.11)</u>	<u>\$ (0.03)</u>
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING		
Basic	<u>2,007,613</u>	<u>2,018,649</u>
Diluted	<u>2,007,613</u>	<u>2,018,649</u>

See notes to financial statements.

IKONICS CORPORATION

**STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2017 AND 2016**

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Total Stock- holders' Equity</u>
	<u>Shares</u>	<u>Amount</u>			
BALANCE AT DECEMBER 31, 2015	2,018,253	\$ 201,825	\$ 2,703,050	\$ 10,590,340	\$ 13,495,215
Net loss	—	—	—	(65,061)	(65,061)
Exercise of stock options and related tax benefit	500	50	3,949	—	3,999
Stock based compensation and related tax benefit	—	—	25,007	—	25,007
BALANCE AT DECEMBER 31, 2016	2,018,753	201,875	2,732,006	10,525,279	13,459,160
Net loss	—	—	—	(226,147)	(226,147)
Exercise of stock options and related tax benefit	250	25	1,798	—	1,823
Common stock repurchased	(35,450)	(3,545)	(47,975)	(248,946)	(300,466)
Stock based compensation	—	—	23,561	—	23,561
BALANCE AT DECEMBER 31, 2017	<u>1,983,553</u>	<u>\$ 198,355</u>	<u>\$ 2,709,390</u>	<u>\$ 10,050,186</u>	<u>\$ 12,957,931</u>

See notes to financial statements.

IKONICS CORPORATION

**STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2017 AND 2016**

	Year Ended December 31,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (226,147)	\$ (65,061)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	836,877	760,772
Amortization	38,265	33,768
Stock based compensation	23,561	25,007
Net gain on sale and disposal of property, plant and equipment	(28,689)	(5,750)
Deferred income taxes	(302,000)	61,000
Changes in working capital components:		
Trade receivables	146,241	(171,307)
Inventories	(99,893)	133,633
Prepaid expenses and other assets	193,663	(276,257)
Income tax receivable	64,003	36,831
Accounts payable	(408,526)	310,141
Accrued expenses	(32,666)	74,170
Net cash provided by operating activities	<u>204,689</u>	<u>916,947</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant, equipment and construction in progress	(230,089)	(2,064,426)
Proceeds from sale of property and equipment	32,635	21,000
Purchases of intangibles	(38,977)	(27,146)
Purchases of short-term investments	(3,875,000)	(4,379,000)
Proceeds on sale of short-term investments	4,226,000	1,133,000
Net cash provided by (used in) investing activities	<u>114,569</u>	<u>(5,316,572)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term debt	—	3,415,000
Payment of debt issuance costs	—	(139,418)
Payments on long-term debt	(139,690)	(79,475)
Repurchase of common stock	(300,466)	—
Proceeds from exercise of stock options	1,885	3,765
Net cash (used in) provided by financing activities	<u>(438,271)</u>	<u>3,199,872</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(119,013)	(1,199,753)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>1,048,713</u>	<u>2,248,466</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 929,700</u>	<u>\$ 1,048,713</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	<u>\$ 70,990</u>	<u>\$ 43,421</u>
Cash received for income taxes, net	<u>\$ 60,003</u>	<u>\$ 102,234</u>

See notes to financial statements.

IKONICS CORPORATION

NOTES TO FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2017 AND 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business and Foreign Export Sales - IKONICS Corporation's (the Company or IKONICS) traditional business has been the development and manufacturing of high-quality photochemical imaging systems for sale primarily to a wide range of printers and decorators of surfaces. Customers' applications are primarily screen printing and abrasive etching. These sales have been augmented with inkjet receptive films, ancillary chemicals and related equipment to provide a full line of products and services to its customers. Leveraging these technologies the Company is also diversifying and expanding its business to industrial markets. These efforts also include the Company's Advanced Material Solutions (AMS) business unit which uses the Company's proprietary process and photoresist film for the abrasive etching of composite materials, industrial ceramics, silicon wafers, and glass wafers. The customer base for AMS is primarily the aerospace and electronics industries. Based on its expertise in ultraviolet curable fluids and inkjet receptive substrates, the Company has also developed a patented digital texturing technology (DTX) for putting patterns and textures into steel molds for the plastic injection molding industry. The original equipment manufacturer ("OEM") for the Company's DTX technology is primarily the automotive industry. Industrial inkjet printers, which are integral to the DTX system, are manufactured and sold by a strategic partner. The Company's business plan is to sell a suite of products including consumable fluids and transfer films. For most markets these sales are direct to the mold maker. The DTX technology is being expanded to prototyping where the Company's technology offers a unique combination of high definition and large format prints. The Company's principal markets are throughout the United States. In addition, the Company sells to Europe, Latin America, Asia, and other parts of the world. The Company extends credit to its customers, all on an unsecured basis, on terms that it establishes for individual customers.

Foreign sales approximated 31.0% and 28.0% of net sales in 2017 and 2016, respectively. The Company's trade receivables at December 31, 2017 and 2016 due from foreign customers were 25.5% and 23.6% of total trade receivables, respectively. The foreign export receivables are comprised primarily of open credit arrangements with terms ranging from 30 to 90 days. No single customer or foreign country represented greater than 10% of net sales in 2017 or in 2016.

The Company considers events or transactions that occur after the balance sheet date but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure.

A summary of the Company's significant accounting policies follows:

Cash Equivalents — The Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents consist of money market funds in which the carrying value approximates fair value because of the short maturity of these instruments. The money market fund invests in United States dollar denominated securities that present minimal credit risk and consist of investments in debt securities issued or guaranteed by the United States government or by United States government agencies or instrumentalities, repurchase agreements fully collateralized by the United States Treasury, and United States government securities.

Short-Term Investments — Short-term investments consist of fully insured certificates of deposit with original maturities ranging from one to twelve months as of both December 31, 2017 and 2016.

Trade Receivables — Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on an on-going basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received. Accounts are considered past due if payment is not received according to agreed-upon terms.

A small percentage of the trade receivables balance is denominated in a foreign currency with no concentration in any given country. At the end of each reporting period, the Company analyzes the receivable balance for customers paying in a foreign currency. These balances are adjusted to each quarter or year-end spot rate in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standard Codification (“ASC”) No. 830, Foreign Currency Matters. Foreign currency transactions and translation adjustments did not have a significant effect on the Balance Sheets or the Statements of Operations, Stockholders’ Equity and Cash Flows for 2017 and 2016.

Inventories — Inventories are stated at the lower of cost or market using the last-in, first-out (LIFO) method. If the first-in, first-out (FIFO) cost method had been used, inventories would have been approximately \$1,183,000 and \$1,127,000 higher than reported at December 31, 2017 and 2016, respectively. The inventory reserve for obsolescence was \$7,000 and \$5,000 at December 31, 2017 and 2016, respectively. The major components of inventories are as follows:

	<u>Dec 31, 2017</u>	<u>Dec 31, 2016</u>
Raw materials	\$ 1,428,924	\$ 1,438,471
Work-in-progress	423,186	355,208
Finished goods	1,416,547	1,319,856
Reduction to LIFO cost	<u>(1,182,592)</u>	<u>(1,127,363)</u>
Total Inventories	<u>\$ 2,086,065</u>	<u>\$ 1,986,172</u>

Property, Plant and Equipment — Major expenditures extending the life of the property, plant and equipment are capitalized. Repair and maintenance costs are expensed in the period in which they are incurred. Depreciation of property, plant and equipment is computed using the straight-line method over the following estimated useful lives:

	<u>Years</u>
Buildings	15-40
Machinery and equipment	5-10
Office equipment	3-10
Vehicles	3

Intangible Assets — Intangible assets consist of patents and licenses. Intangible assets are amortized on a straight-line basis over their estimated useful lives or agreement terms.

As of December 31, 2017, the remaining estimated weighted average useful lives of intangible assets are as follows:

	<u>Years</u>
Patents	10.6
Licenses	0.3

Impairment of Long-lived Assets — The Company reviews its long-lived assets, including property, plant and equipment and intangible assets, for impairment when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets’ carrying amount. Any impairment loss recorded is measured as the amount by which the carrying value of the assets exceeds the fair value of the assets. To date, the Company has determined that no loss on impairment of long-lived assets exists.

Fair Value of Financial Instruments — The carrying amounts of financial instruments, including cash and cash equivalents, short-term investments, trade receivables, accounts payable, and accrued liabilities approximate fair value due to the short maturities of these instruments. The fair value of long-term debt approximates its carrying value and has been estimated based on interest rates being offered for similar debt having the same or similar remaining maturities and collateral requirements.

Revenue Recognition — The Company recognizes revenue on sales of products when title passes which can occur at the time of shipment or when the goods arrive at the customer location depending on the agreement with the customer. The Company sells its products to both distributors and end-users. Sales to distributors and end-users are recorded based upon the criteria governed by the sales, delivery, and payment terms stated on the invoices from the Company to the purchaser. In addition to transfer of title / risk of loss, all revenue is recorded in accordance with the criteria outlined:

- (a) persuasive evidence of an arrangement (principally in the form of customer sales orders and the Company's sales invoices, as generally there is no other formal agreement underlying the sale transactions);
- (b) delivery and performance (evidenced by proof of delivery, e.g. the shipment of film and substrates with bill of lading used for proof of delivery for FOB shipping point terms, and the carrier booking confirmation report used for FOB destination terms. Once the finished product is shipped and physically delivered under the terms of the invoice and sales order, the Company has no additional performance or service obligations to complete);
- (c) a fixed and determinable sales price (the Company's pricing is established and is not based on variable terms, as evidenced in either the Company's invoices or the limited number of distribution agreements; the Company rarely grants extended payment terms and has no history of concessions); and
- (d) a reasonable likelihood of payment (the Company's terms are standard, and the Company does not have a history of significant customer defaults or non-payment).

Sales are reported on a net basis by deducting credits, estimated normal returns and discounts. The Company's return policy does not vary by geography. The customer has no rotation or price protection rights and the Company is not under a warranty obligation. Freight billed to customers is included in sales. Shipping costs are included in cost of goods sold.

Deferred Taxes — Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company classifies deferred tax assets and liabilities as noncurrent. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. The Tax Cut and Jobs Act of 2017 (the "Tax Reform Act") was enacted December 22, 2017. This legislation makes significant changes in U.S. tax law including a reduction in the corporate tax rates, changes to net operating loss carryforwards and carrybacks and a repeal of the corporate alternative minimum tax. The legislation reduced the U.S. corporate tax rate from the current rate of 34% and 35% to 21%. As a result of the enacted law, the Company was required to revalue deferred tax assets and liabilities at the newly enacted rate. This revaluation resulted in a benefit of \$115,000 to income tax expense in continuing operations and a corresponding reduction in the deferred tax liability. The other provisions of the Tax Reform Act did not have a material impact on the 2017 consolidated financial statements.

The Company follows the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses derecognition, classification, interest and penalties on income taxes, and accounting in interim periods.

Earnings Per Common Share (EPS) — Basic EPS is calculated using net income (loss) divided by the weighted average of common shares outstanding. Diluted EPS is similar to Basic EPS except that the weighted average number of common shares outstanding is increased to include the number of additional common shares, when

dilutive, that would have been outstanding if the potential dilutive common shares, such as those shares subject to options, had been issued.

Shares used in the calculation of diluted EPS are summarized below:

	<u>2017</u>	<u>2016</u>
Weighted average common shares outstanding	2,007,613	2,018,649
Dilutive effect of stock options	—	—
Weighted average common and common equivalent shares outstanding	<u>2,007,613</u>	<u>2,018,649</u>

If the Company was in a net income position at December 31, 2017, 2,250 options with a weighted average exercise price of \$8.91 would have been included as part of the weighted average common and common equivalent shares outstanding as the options would have been dilutive, while 15,918 options with a weighted average exercise price of \$14.51 would have remained excluded as the options were anti-dilutive.

If the Company was in a net income position at December 31, 2016, 4,750 options with a weighted average exercise price of \$10.58 would have been included as part of the weighted average common and common equivalent shares outstanding as the options would have been dilutive, while 11,418 options with a weighted average exercise price of \$15.99 would have remained excluded as the options were anti-dilutive.

Employee Stock Plan - The Company accounts for employee stock options under the provision of ASC 718, Compensation — Stock Compensation.

Recent Accounting Pronouncements:

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09 supersedes the revenue recognition requirements in *Revenue Recognition (Topic 605)*, and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers: Deferral of the Effective Date*, which defers the adoption of ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The standard permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method). The standard also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract.

The Company will adopt the provisions of ASU 2014-09 on January 1, 2018 using the modified retrospective method. While most of the Company's revenue is contracted with customers through one-time purchase orders and short-term contracts, the Company does have long-term contracts with certain customers. The Company is nearly complete with its evaluation of the effect of adoption on its financial statements, and will expand its financial statement disclosures in future periods in order to comply with the new standard. For the revenue streams assessed, the Company does not anticipate any adjustments regarding the timing of recognizing revenue as a result of the adoption. The Company does not incur upfront costs to obtain a contract and, upon adoption, the Company will elect to treat delivery costs as a fulfillment activity that are expensed as incurred.

During February 2016, the FASB issued ASU No. 2016-02, *Leases*. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing all lease transactions (with terms in excess of 12 months) on the balance sheet as a lease liability and a right-of-use asset (as defined). ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with earlier application permitted. Upon adoption, the lessee will apply the new standard retrospectively to all periods presented or retrospectively using a cumulative effect adjustment in the year of adoption. The Company is currently assessing the effect that ASU No. 2016-02 will have on its financial statements.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation—Stock Compensation* (Topic 718). This standard makes several modifications to Topic 718 related to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. ASU 2016-09 also clarifies the statement of cash flows presentation for certain components of share-based awards. The standard is effective for interim and annual reporting periods beginning after December 15, 2016, although early adoption is permitted. The Company adopted ASU No. 2016-09 in 2017 with minimal impact on the financial statements.

Use of Estimates — The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include the allowance for doubtful trade receivables, the reserve for inventory obsolescence, and the valuation allowance for deferred tax assets.

2. INCOME TAXES

Income tax expense (benefit) for the years ended December 31, 2017 and 2016 consists of the following:

The Tax Cut and Jobs Act of 2017 (the “Tax Reform Act”) was enacted December 22, 2017. This legislation makes significant changes in U.S. tax law including a reduction in the corporate tax rates, changes to net operating loss carryforwards and carrybacks and a repeal of the corporate alternative minimum tax. The legislation reduced the U.S. corporate tax rate from the current rate of 34% and 35% to 21%. As a result of the enacted law, the Company was required to revalue deferred tax assets and liabilities at the newly enacted rate. This revaluation resulted in a benefit of \$115,000 to income tax expense in continuing operations and a corresponding reduction in the deferred tax liability. The other provisions of the Tax Reform Act did not have a material impact on the 2017 consolidated financial statements.

	<u>2017</u>	<u>2016</u>
Current:		
Federal	\$ (5,000)	\$ (72,000)
State	9,000	7,000
	4,000	(65,000)
Deferred - Federal	<u>(302,000)</u>	<u>61,000</u>
	<u>\$ (298,000)</u>	<u>\$ (4,000)</u>

The expected provision benefit for income taxes, computed by applying the U.S. federal income tax rate of 34% in 2017 and 2016 to income (loss) before taxes, is reconciled to income benefit as follows:

	<u>2017</u>	<u>2016</u>
Expected provision for federal income taxes	\$ (178,000)	\$ (23,000)
State income taxes, net of federal benefit	2,000	7,000
Non-deductible meals, entertainment, and life insurance	29,000	27,000
Research and development credit	(38,000)	(32,000)
Change in valuation allowance	16,000	15,000
Tax rate change adjustment related to Tax Reform Act	(115,000)	-
Prior year true-ups and other	(14,000)	2,000
	<u>\$ (298,000)</u>	<u>\$ (4,000)</u>

Net deferred tax liabilities consist of the following as of December 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Deferred tax liabilities:		
Accrued vacation	\$ 19,000	\$ 32,000
Inventories reserve	46,000	66,000
Allowance for doubtful accounts	2,000	4,000
Allowance for sales returns	9,000	15,000
Research and development credit carryforward	131,000	77,000
Accrued self-insured medical	1,000	3,000
Property and equipment	(242,000)	(499,000)
Intangible assets	(65,000)	(92,000)
Net operating loss	40,000	-
Other	6,000	8,000
Valuation allowance	(91,000)	(60,000)
Net deferred tax liabilities	<u>\$ (144,000)</u>	<u>\$ (446,000)</u>

The Company's federal net operating loss carryforward and research and development credit carryover as of December 31, 2017 was \$167,000 and \$40,000, respectively, and will begin to expire in 2036. The Company's state net operating loss carryforwards at December 31, 2017 total \$834,000 and begin expiring in 2026. The Company has state research and development credit carryforwards as of December 31, 2017 of \$115,000.

The valuation allowance balance of \$91,000 and \$60,000 at December 31, 2017 and 2016, relates entirely to Minnesota research and development credit carryforwards that the Company does not expect to utilize and begin to expire in 2028. The change in the valuation allowance was \$31,000 in 2017 and \$15,000 in 2016. Approximately \$15,000 of the \$31,000 change in 2017 is a result of recording the impact of the revaluation on these credits and corresponding increase in valuation allowance related to the Tax Reform Act discussed above.

It has been the Company's policy to recognize interest and penalties related to uncertain tax positions in income tax expense. As of December 31, 2017 and 2016, there was no liability for unrecognized tax benefits.

The Company is subject to federal and state taxation. As of December 31, 2017, with few exceptions, the Company is no longer subject to examination prior to tax year 2014.

3. INTANGIBLE ASSETS

Intangible assets consist of patents, patent applications, and licenses. Capitalized patent application costs are included with patents. Intangible assets are amortized on a straight-line basis over their estimated useful lives or terms of their agreement, whichever is shorter. There were no abandonments or impairment adjustments to intangible assets during the years ended December 31, 2017 and 2016.

Intangible assets at December 31, 2017 and 2016 consist of the following:

	<u>December 31, 2017</u>		<u>December 31, 2016</u>	
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Amortized intangible assets:				
Patents	\$ 476,177	\$ (126,032)	\$ 437,199	\$ (103,238)
License	50,000	(48,959)	50,000	(45,834)
	<u>\$ 526,177</u>	<u>\$ (174,991)</u>	<u>\$ 487,199</u>	<u>\$ (149,072)</u>
Aggregate amortization expense:			<u>2017</u>	<u>2016</u>
For the years ended December 31			\$ 25,919	\$ 25,115

Estimated amortization expense for the years ending December 31:

2018	\$ 24,000
2019	23,000
2020	22,000
2021	22,000
2022	22,000

In connection with the license agreement, the Company has agreed to pay royalties ranging from 3% to 5% on the sales of products subject to the agreements. The Company incurred \$11,000 and \$12,000 of expense under these agreements during 2017 and 2016, respectively, which are included in selling, general and administrative expenses in the Statements of Operations.

4. RETIREMENT PLAN

The Company has established a salary deferral plan under Section 401(k) of the Internal Revenue Code. Such deferrals accumulate on a tax-deferred basis until the employee withdraws the funds. The Company contributes up to 5% of each eligible employee's compensation. Total retirement expense for the years ended December 31, 2017 and 2016 was approximately \$235,000 and \$236,000, respectively.

5. SEGMENT INFORMATION

The Company's reportable segments are strategic business units that offer different products and have varied customer bases. There are five reportable segments: Domestic, Export, IKONICS Imaging, DTX and AMS. Domestic sells screen printing film, emulsions, and inkjet receptive film to distributors located in the United States and Canada. IKONICS Imaging sells photo resistant film, art supplies, glass, metal medium and related abrasive etching equipment to end user customers located in the United States and Canada. AMS provides sound deadening technology to the aerospace industry along with products and services for etched composites, ceramics, glass and silicon wafers. DTX includes products and customers related to patented and proprietary inkjet technology used for mold texturing and prototyping. Export sells primarily the same products as Domestic and the IKONICS Imaging products not related to AMS or DTX. The accounting policies of the segments are the same as those described in the summary of significant accounting policies included in Note 1.

Management evaluates the performance of each segment based on the components of divisional income, and does not allocate assets and liabilities to segments except for trade receivables. Financial information with respect to the reportable segments follows:

For the year ended December 31, 2017:

	Domestic	Export	IKONICS Imaging	DTX	AMS	Unalloc.	Total
Net sales	\$ 6,934,433	\$ 4,722,950	\$ 4,021,970	\$ 817,640	\$ 746,251	\$ —	\$ 17,243,244
Cost of goods sold	4,100,497	3,721,800	1,915,390	487,509	1,287,503	—	11,512,699
Gross profit (loss)	2,833,936	1,001,150	2,106,580	330,131	(541,252)	—	5,730,545
Selling, general, and administrative*	1,345,427	645,973	1,065,957	168,553	376,498	1,904,058	5,506,466
Research and development*	—	—	—	—	—	688,688	688,688
Income (loss) from operations	\$ 1,488,509	\$ 355,177	\$ 1,040,623	\$ 161,578	\$ (917,750)	\$ (2,592,746)	\$ (464,609)

For the year ended December 31, 2016:

	<u>Domestic</u>	<u>Export</u>	<u>IKONICS Imaging</u>	<u>DTX</u>	<u>AMS</u>	<u>Unalloc.</u>	<u>Total</u>
Net sales	\$ 7,361,222	\$ 4,508,577	\$ 4,253,249	\$ 404,898	\$ 1,041,955	\$ —	\$ 17,569,901
Cost of goods sold	4,203,125	3,501,769	1,906,664	162,376	1,559,057	—	11,332,991
Gross profit (loss)	3,158,097	1,006,808	2,346,585	242,522	(517,102)	—	6,236,910
Selling, general, and administrative*	1,396,266	650,513	1,052,823	144,970	419,469	1,947,808	5,611,849
Research and development*	—	—	—	—	—	647,065	647,065
Income (loss) from operations	\$ 1,761,831	\$ 356,295	\$ 1,293,762	\$ 97,552	\$ (936,571)	\$ (2,594,873)	\$ (22,004)

* The Company does not allocate all general and administrative expenses or any research and development expenses to its operating segments for internal reporting.

Trade receivables by segment as of December 31, 2017 and December 31, 2016 were as follows:

	<u>Dec 31, 2017</u>	<u>Dec 31, 2016</u>
Domestic	\$ 1,119,228	\$ 1,206,866
Export	558,872	551,803
IKONICS Imaging	238,813	363,602
DTX	64,278	52,935
AMS	238,848	177,374
Unallocated	(29,779)	(16,079)
Total	\$ 2,190,260	\$ 2,336,501

6. STOCKHOLDERS' EQUITY

The Company has a stock incentive plan for the issuance of up to 442,750 shares of common stock. The plan provides for granting eligible participants stock options or other stock awards, as described by the plan, at prices ranging from 85% to 110% of fair market value at date of grant. Options granted expire up to seven years after the date of grant. Such options generally become exercisable over a three year period. A total of 101,989 shares of common stock are reserved for additional grants of options under the plan as of December 31, 2017.

Under the plan, the Company charged compensation expense of \$23,561 and \$25,007 against income in 2017 and 2016, respectively.

As of December 31, 2017, there was approximately \$17,000 of unrecognized compensation expense related to unvested share-based compensation awards granted which is expected to be recognized over the next three years.

Proceeds from the exercise of stock options were approximately \$2,000 and \$4,000 for 2017 and 2016, respectively.

The fair value of options granted during 2017 and 2016 was estimated using the Black-Scholes option pricing model with the following assumptions:

	<u>2017</u>	<u>2016</u>
Dividend yield	0%	0%
Expected volatility	41.3%	42.4%
Expected life of option	Five Years	Five Years
Risk-free interest rate	1.8%	1.3%
Fair value of each option on grant date	\$ 3.43	\$ 4.02

There were 2,250 and 4,500 options granted during 2017 and 2016, respectively.

A summary of the status of the Company's stock option plan as of December 31, 2017 and changes during the year then ended is presented below:

	Shares	Weighted Average Exercise Price
Outstanding at January 1, 2017	16,168	\$ 14.40
Granted	2,250	8.91
Exercised	(250)	7.54
Outstanding at December 31, 2017	<u>18,168</u>	<u>\$ 13.81</u>
Exercisable at December 31, 2017	<u>10,499</u>	<u>\$ 15.41</u>

The weighted-average grant date fair value of options granted was \$3.43 and \$4.02 for the years ended December 31, 2017 and 2016, respectively. The total intrinsic value of stock options exercised was \$490 and \$2,160 for the years ended December 31, 2017 and 2016, respectively.

In prior years, the Company's board of directors had authorized the repurchase of up to 250,000 shares of common stock. A total of 219,589 shares were repurchased under this program including 1,950 shares repurchased during the second quarter of 2017. As of August 2, 2017, the plan allowed for an additional 30,411 shares to be repurchased. On August 3, 2017, the Company's board of directors approved a new repurchase authorization for up to 100,000 shares of the Company's common stock, which replaces all prior authorizations. Shares repurchased under this new authorization may be made through open market and privately negotiated transactions from time to time. The new share repurchase authorization does not have an expiration date. Subsequent to August 2, 2017 the Company repurchased 33,500 shares for \$278,620. During 2017, the Company repurchased 25,000 shares for \$218,750 from a beneficial shareholder holding more than 5% of outstanding common stock.

7. CONCENTRATION OF CREDIT RISK

The Company maintains its cash balances primarily in two financial institutions. As of December 31, 2017, the balance at one of the institutions exceeded the Federal Deposit Insurance Corporation coverage.

Trade receivables are financial instruments that also expose the Company to concentration of credit risk. The large number of customers comprising the Company's customer base and their dispersion across different geographic areas limits such exposure. In addition, the Company routinely assesses the financial strength of its customers and maintains an allowance for doubtful accounts that management believes will adequately provide for credit losses.

8. LONG-TERM DEBT

On April 1, 2016, the Company entered into a financing agreement (the "Financing Agreement") under which the Duluth Economic Development Authority (the "Issuer") agreed to sell \$3,415,000 of its Tax Exempt Industrial Revenue Bonds, Series 2016 (IKONICS Project) (the "Bonds") to Wells Fargo Bank, National Association (the "Bank"), and the Bank agreed to lend to the Company the proceeds received from the sale of the Bonds (the "Loan").

The closing of the sale of the Bonds occurred on April 29, 2016. The proceeds from the Loan were used to finance the construction of a 27,300-square foot building as well as related equipment for use in the Company's manufacture of sound deadening technology used in the aerospace industry and products consisting of etched composites, ceramics, glass and silicon wafers, to be located in Duluth, Minnesota (the "Project").

The Loan requires monthly payments of approximately \$18,000, including interest. The Loan bears interest at a rate of 2.14% per year, subject to change based upon changes to the maximum federal corporate tax rate, payable

monthly, and matures on April 1, 2041. Including debt costs of approximately \$139,000, the Loan's effective interest rate was 2.77% at December 31, 2017. As a result of the Tax Reform Act described in Note 2, the Company estimates the future effective interest rate will be approximately 3.23% beginning in March 2018, resulting in an approximate \$15,000 increase in interest payments annually.

The Loan is subject to mandatory purchase provisions, under which any owners of the Bonds (the "Owners") may tender the Bonds to the Issuer on April 1, 2021, which would result in the Company repaying the outstanding loan principal and any outstanding accrued and unpaid interest to the Issuer at that time. If in the event the Bonds are not repurchased on April 1, 2021, the Bonds shall be subject to the interest rate and redemption provisions set forth in the associated covenant agreement.

Subject to limitations in the associated covenant agreement, the Company may cause a redemption of the Bonds, in whole or in part, in authorized denominations at the redemption prices set forth in the Financing Agreement, together with any accrued or unpaid interest to the date of redemption. The Bonds are also subject to redemption in whole in the event of certain extraordinary events related to the Project.

The Company is subject to certain customary covenants set forth in the associated covenant agreement, including a requirement that the Company maintain a debt service coverage ratio as of the end of each calendar quarter of not less than 1.25 to 1.00 on a rolling four-quarter basis.

The remaining principal payments required under the agreement for years ended December 31, and the current and long-term portion of the principal, are as follows:

2018	143,000
2019	146,000
2020	149,000
2021	152,000
2022	156,000
Thereafter	2,450,000
Total Principal	3,196,000
Less: Unamortized debt issuance costs	118,000
Less: Current portion	131,000
Long-term portion	<u>\$2,947,000</u>

In connection with the agreement, the Company incurred debt issuance costs of approximately \$139,000 during 2016, which were deferred and are being amortized over the term of the Financing Agreement. Amortization of debt issuance costs was approximately \$12,000 for 2017 and \$9,000 for 2016 and is included in interest expense. Debt issuance costs of \$106,000 and \$12,000 are netted against long-term debt and current portion of long-term debt, respectively as of December 31, 2017. Amortization of debt costs is expected to be approximately \$10,000 annually for each of the next five years.

In addition to the \$3,415,000 in indebtedness pursuant to the Loan, the Company has a bank line of credit providing for borrowings of up to \$2,050,000, expiring on June 30, 2019 that bears interest at 1.8 percentage points over the 30-day LIBOR rate. The Company did not utilize this line of credit during 2017 or 2016 and there were no borrowings outstanding as of December 31, 2017 and 2016. There are no financial covenants related to the line of credit and the Company expects to obtain a similar line of credit when the current line of credit expires.

Both the \$3,415,000 financing pursuant to the Loan and the line of credit are collateralized by substantially all assets of the Company.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures. As of December 31, 2017, an evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”). Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms.

Management’s Annual Report on Internal Control Over Financial Reporting. Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control system is designed to provide reasonable assurance to our management and board of directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2017. In making this assessment, management used the 2013 criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control — Integrated Framework*. Based on management’s assessment and those criteria, management believes that, as of December 31, 2017, the Company maintained effective internal control over financial reporting.

This annual report does not include an attestation report of the Company’s registered public accounting firm regarding internal control over financial reporting. Our management’s report of the effectiveness on the design and operation of our internal control over financial reporting was not subject to attestation by the Company’s registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company to provide only management’s report in this annual report.

Changes in Internal Control Over Financial Reporting. There was no change in the Company’s internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and Rule 15d-15(d) of the Exchange Act that occurred during the period covered by this report and that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information to be included in the Company's definitive proxy statement for the 2018 Annual Meeting of Shareholders under the captions "Election of Directors," "Executive Officers" and "Section 16(a) Beneficial Ownership Reporting Compliance" is incorporated by reference. The following information completes the Company's response to this Item 10.

The Company has adopted a code of ethics that applies to the Company's Chief Executive Officer, Chief Financial Officer, Controller and other employees performing similar functions. This code of ethics is filed as Exhibit 14 to this report. The Company intends to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or a waiver from, this code of ethics by posting such information on its web site which is located at www.ikonics.com.

Item 11. Executive Compensation

The information to be included in the Company's definitive proxy statement for the 2018 Annual Meeting of Shareholders under the captions "Election of Directors—Director Compensation," "Summary Compensation Table," "Outstanding Equity Awards at Fiscal Year-End" and "Employment Contracts; Termination of Employment and Change-In-Control Arrangements" is incorporated by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information to be included in the Company's definitive proxy statement for the 2018 Annual Meeting of Shareholders under the captions "Security Ownership of Principal Shareholders and Management" and "Equity Compensation Plan Information" is incorporated by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information to be included in the Company's definitive proxy statement for the 2018 Annual Meeting of Shareholders under the caption "Election of Directors" is incorporated by reference. The Company has not engaged in any transaction since the beginning of its last fiscal year and does not currently propose to engage in any transaction required to be disclosed pursuant to Item 404 of Regulation S-K.

Item 14. Principal Accountant Fees and Services

The information to be included in the Company's definitive proxy statement for the 2018 Annual Meeting of Shareholders under the caption "Principal Accounting Firm Fees" is incorporated by reference.

Item 15. Exhibits and Financial Statement Schedules

(a)(1) The following financial statements of the Company are filed as part of this Annual Report on Form 10-K;

- (i) Report of RSM US LLP, independent registered public accounting firm
- (ii) Balance Sheets as of December 31, 2017 and 2016
- (iii) Statements of Operations for the years ended December 31, 2017 and 2016
- (iv) Statements of Stockholders' Equity for the years ended December 31, 2017 and 2016
- (v) Statements of Cash Flows for the years ended December 31, 2017 and 2016
- (vi) Notes to the Financial Statements

(b) The following exhibits are filed as part of this Annual Report on Form 10-K for the fiscal year ended December 31, 2017:

Exhibit	Description
3.1	Restated Articles of Incorporation of Company, as amended. (Incorporated by reference to the like numbered Exhibit to the Company's Registration Statement on Form 10-SB filed with the Commission on April 7, 1999 (Registration No. 000-25727)).
3.2	By-Laws of the Company, as amended. (Incorporated by reference to the like numbered Exhibit to the Company's Current Report on Form 8-K filed with the Commission on February 22, 2007 (File No. 000-25727)).
4	Specimen of Common Stock Certificate. (Incorporated by reference to the like numbered Exhibit to Amendment No. 1 to the Company's Registration Statement on Form 10-SB filed with the Commission on May 26, 1999 (Registration No. 000-25727)).
10.1*	IKONICS Corporation 1995 Stock Incentive Plan, as amended. (Incorporated by reference to the like numbered Exhibit to the Company's Annual Report on Form 10-K filed with the Commission on March 3, 2011 (File No. 000-25727)).
10.2	Confidentiality Agreement, dated March 11, 2013, between the Company and Joseph R. Nerges. (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on March 13, 2013 (File No. 000-25727)).
10.3	Financing Agreement dated April 1, 2016 by and between Duluth Economic Development Authority, the Company and Wells Fargo Bank, National Association. (Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed with the Commission on May 12, 2016 (File No. 000-25727)).
14	Code of Ethics. (Incorporated by reference to the like numbered Exhibit to the Company's Annual Report on Form 10-KSB for the year ended December 31, 2003 (File No. 000-25727)).
23	Consent of Independent Registered Public Accounting Firm.
24	Powers of Attorney.
31.1	Rule 13a-14(a)/15d-14(a) Certifications of CEO.
31.2	Rule 13a-14(a)/15d-14(a) Certifications of CFO.
32	Section 1350 Certifications.
101	Interactive data files pursuant to Rule 405 of Regulation S-T.**

* Management contract or compensatory plan, contract or arrangement required to be filed as an exhibit to this Annual Report on Form 10-K.

** In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Annual Report on Form 10-K is deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise is not subject to liability under those sections.

IKONICS CORPORATION

Powers of Attorney

The undersigned directors of IKONICS Corporation, a Minnesota corporation, do hereby make, constitute and appoint William C. Ulland and Jon R. Gerlach, and either of them, the undersigned’s true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned’s name, place and stead, to sign and affix the undersigned’s name as such director of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, each of the undersigned have hereunto set their hands as of March 2, 2018.

/s/ William C. Ulland
William C. Ulland

/s/ Jeffrey D. Engbrecht
Jeffrey D. Engrecht

/s/ Gregory W. Jackson
Gregory W. Jackson

/s/ Marianne Bohren
Marianne Bohren

/s/ Ernest M. Harper Jr.
Ernest M. Harper Jr.

/s/ Lockwood Carlson
Lockwood Carlson

/s/ Darrell B. Lee
Darrell B. Lee

RULE 13a-14(a)/15d-14(a) CERTIFICATIONS OF CEO

I, William C. Ulland, certify that:

1. I have reviewed this annual report on Form 10-K of IKONICS Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 2, 2018

/s/ William C. Ulland

William C. Ulland
Chairman, Chief Executive Officer
and President

RULE 13a-14(a)/15d-14(a)/CERTIFICATIONS OF CFO

I, Jon Gerlach, certify that:

1. I have reviewed this annual report on Form 10-K of IKONICS Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 2, 2018

/s/ Jon Gerlach

Jon Gerlach
Chief Financial Officer
and Vice President of Finance

SECTION 1350 CERTIFICATIONS

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned certifies that this periodic report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in this periodic report fairly presents, in all material respects, the financial condition and results of operations of IKONICS Corporation.

Date: March 2, 2018

/s/ William C. Ulland

William C. Ulland
Chairman, Chief Executive Officer
and President

Date: March 2, 2018

/s/ Jon Gerlach

Jon Gerlach
Chief Financial Officer
and Vice President of Finance

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Board of Directors

William C. Ulland	Chairman, President & CEO IKONICS Corporation Duluth, MN Director Since 1972
Marlanne Bohren	Executive Director Western Lake Superior Sanitary District Duluth, MN Director Since 2016
Lockwood Carlson	President Carlson Consulting Group Minneapolis, MN Director Since 2009
Jeffrey D. Engbrecht	President & CEO Clearwater Composites Duluth, MN Director Since 2016
Ernest M. Harper Jr.	Chief Tax Officer (retired 2010) General Mills, Inc. Minneapolis, MN Director Since 2012
Greg W. Jackson	Executive Vice President Taylor Corporation North Mankato, MN Director Since 2017
Darrell B. Lee	Vice President, Chief Financial Officer, Treasurer, Secretary (retired 2014) MOCON, Inc. Minneapolis, MN Director Since 2012

Corporate Officers

William C. Ulland	Chairman, President & CEO
Ken Hegman	Chief Operating Officer
Claude Piguet	Executive Vice President
Jon Gerlach	Vice President, Finance, CFO, Treasurer, and Secretary

Common Stock

IKONICS Corporation common stock is traded on the Nasdaq Capital Market under the symbol IKNX. For investment and stock information contact:

Jon Gerlach
Chief Financial Officer

IKONICS Corporation
4832 Grand Avenue
Duluth, MN 55807
Phone: (218) 628-2217
email: jgerlach@ikonics.com

Transfer Agent

Equinity Shareowner Services
PO Box 64854
St. Paul, MN 55164-0854

Shareholders with questions on stock holdings, transfer requirements and address changes contact Equinity Shareowner Services at: (800) 468-9716

Auditor

RSM US LLP
227 West First Street, Suite 700
Duluth, MN 55802
(218) 727-8253

Counsel

HANFT FRIDE
1000 U.S. Bank Place
130 W. Superior Street
Duluth, MN 55802
(218) 722-4766

Additional Financial Information

For a copy of the Form 10-K, as filed with the Securities and Exchange Commission, and other financial information available at no charge to shareholders, please contact:

Jon Gerlach
CFO

IKONICS Corporation
4832 Grand Avenue
Duluth, MN 55807
Phone: (218) 628-2217
email: jgerlach@ikonics.com

Annual Meeting

The Company's annual meeting of shareholders will be held:

April 26, 2018, 1:00 p.m.
Kitchi Gammi Club
831 E. Superior Street
Duluth, MN 55802

