

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-KSB

(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, 2001

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  
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THE CHROMALINE 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  
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Securities registered under Section 12(b) of the Act: None

Securities registered under Section 12(g) of the Act: Common Stock, par value \$.10 per share

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

Check if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB.

The issuer's revenues for its most recent fiscal year were: \$10,752,133

The aggregate market value of the voting stock held by non-affiliates of the registrant as of February 28, 2002 was \$2,622,193, based on the average of the closing bid and asked prices for the issuer's Common Stock on such date as reported on the Nasdaq SmallCap 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-KSB 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 - - 1,270,527 issued and outstanding as of February 28, 2002.

Transitional Small Business Disclosure Format (check one):

Yes  No

This Annual Report on Form 10-KSB 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. 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. Factors that could cause actual results to differ include the risks, uncertainties and other matters set forth below under the caption "Factors that May Affect Future Results" 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-KSB.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive proxy statement for its 2002 Annual Meeting of Shareholders are incorporated by reference in Part III.

#### PART I

##### ITEM 1. BUSINESS

###### GENERAL

The Chromaline Corporation ("Chromaline" or the "Company") was incorporated in Minnesota as Chroma-Glo, Inc. in 1952 and changed its name to The Chromaline Corporation in 1982. The Company develops, manufactures and sells light sensitive liquid coatings ("emulsions") and light sensitive films for commercial and industrial applications in the United States and abroad. The Company also markets ancillary chemicals and equipment to provide a full line of products and services to its customers. The Company's products serve the screen printing and decorative sand blasting markets. The screen printing products represent the Company's largest product line. These products are used by screen printers to create stencil images. These images produce basic designs for fabric decoration and product identification, as well as complex designs for compact discs and electronic circuits. The sand blasting products are used by many consumers to create architectural glass, art pieces and awards. Some of the Company's customers use both the screen printing and the sand blasting products.

Over the past four years, Chromaline has completed building additions which added additional manufacturing and warehouse space and has installed equipment which doubled the Company's coated film production capacity. During this period, the Company has grown by introducing new products, including:

- o Chroma/Tech SR - a new solvent resistant pure photopolymer emulsion.
- o Magna/Cure UDC 2 and 3 - universal dual cure emulsions.
- o Chroma/Tech PL-2 - pure photopolymer emulsion for use with plastisol inks.
- o Magna/Cure UDC-HV - universal dual cure with high viscosity.
- o MAX-R emulsion - for maximum resistance to water or solvent base inks.
- o PHAT film - for screen printing images that require 100 microns to 700 microns of new high density plastisol inks.
- o DuraMask - an additional improved photoresist film for the decorative sandblasting industry.
- o UDC-ACE emulsion - screen emulsion for use in automatic coating machines.
- o Reflex gelatin film - image transfer film for use in electronic and circuit board printing.
- o Spike 420 CT - pure photopolymer emulsion for use with plastisol inks.
- o Spike 420 UDC - universal dual cure emulsion.
- o ImagePro Red - improved photoresist film for the decorative sandblasting industry.
- o UltraPro - self-adhesive film for the decorative sandblasting industry.
- o BAT - blastable, water-soluble adhesive tape for the decorative sandblasting industry.
- o RapidMask - a quicker-drying photoresist film for the sandcarving industry.
- o AccuArt - a waterproof ink jet printer film used for the creation of film positives in the printing industry.

- o U.V. Minder - a radiometer/dosimeter for measuring and testing U.V. exposure units.

## PRODUCTS

Chromaline's core technology is photochemical imaging systems. This technology is similar to photographic film technology except that the Company uses organic polymers or natural protein rather than silver to make the product photo-reactive ("light sensitive"). The products Chromaline targets at the screen printing industry are light sensitive films and light sensitive liquid coatings ("emulsions") used by customers to create an image on a printing screen; the equivalent of a printing plate in other types of printing processes. In the sand blasting market, the Company's products are also films and emulsions. These products are used to create a stencil by decorators of glass and other hard surfaces including crystal, marble, metals, wood, stone and plastics. The stencil is applied directly to the article to be decorated by the sand blasting process through a self-adhesive feature or with a separate adhesive. The open areas of the stencil permit the sand blast grit to erode the surface while the closed areas of the stencil repel the sand blast grit, protecting areas of the surface being decorated.

All of Chromaline's light sensitive products are sensitive to ultraviolet radiation. The Company uses different chemicals to create sensitivity to light including a molecule which it developed internally and patented.

## DISTRIBUTION

The Company currently has approximately 140 domestic and international distributors. Chromaline sells its products through non-exclusive distributors in competitive markets, such as the United States, Canada and Mexico. The Company has exclusive distribution arrangements in markets such as South and Central America, Australia, South Africa, Canada, India and other Asian countries. The Company also sells its products through direct sales to certain end users who do not require the services of a distributor or dealer to service their account. The Company serves the European market entirely through direct sales. In addition, Chromaline markets and sells its products through magazine advertising, trade shows and the internet.

Chromaline has a diverse customer base both domestically and abroad and does not depend on one or a few customers for a material portion of its revenues.

## QUALITY CONTROL IN MANUFACTURING

In March 1994, Chromaline became the first firm in northern Minnesota to receive ISO 9001 certification. ISO 9000 is a series of worldwide standards issued by the International Organization for Standardization that provide a framework for quality assurance. ISO 9001 is the most comprehensive standard of the ISO 9000 series. The Company was recertified in 1997 and 1999. Chromaline's quality function goal is to train all employees properly in both their work and in the importance of their work. Responsibility for efficient and correct work has meant that authority for proposing changes has been given to all employees. Internal records of quality-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 environmental testing and screen print equipment tailored to fit customers' needs.

## RESEARCH AND DEVELOPMENT/INTELLECTUAL PROPERTY

Chromaline spent 7.4% of sales (\$793,000) on research and development in 2001 and 7.6% (\$786,000) in 2000. In its research program, Chromaline has developed unique light sensitive molecules which have received two U.S. patents. These patents expire in 2011 and 2014, respectively. In addition, the Company holds a number of other patents related to its photopolymer chemistry that expire between 2003 and 2017. The Company also has three United States patent applications pending. There can be no assurance that any patent granted to the Company will provide adequate protection to the Company's intellectual property. Within Chromaline, steps are taken to protect the Company's trade secrets, including physical security, confidentiality and non-competition agreements with employees and confidentiality agreements with vendors. In its product development program, Chromaline is fully equipped to simulate customer uses of its products. The Company's facilities include a walk-in environmental chamber which simulates customer uses and storage conditions of Chromaline products for different climatic zones.

In addition to its patents, the Company has various trademarks including the "Chromaline," "PhotoBrasive" and "Nichols" trademarks.

## RAW MATERIALS

The primary raw materials used by Chromaline in its production are photopolymers, polyester films, polyvinylacetates, polyvinylalcohols and water. The Company purchases raw materials from a variety of domestic and foreign sources with no one supplier being material to the Company. The purchasing staff at the Company's headquarters leads in the identification of both domestic and foreign sources for raw materials and negotiates price and terms for all domestic and foreign markets. Chromaline's involvement in foreign markets has given it the opportunity to become a global buyer of raw materials at lower overall cost than it had previously enjoyed. The Company has a number of suppliers and no one supplier is essential to the Company's operations. To date there have been no significant shortages of raw materials and alternative sources for nearly all raw materials are available. 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. The screen printing market is much larger than the decorative sand blasting market, however, the sand blasting market is currently experiencing faster growth. Chromaline has two primary competitors in its screen printing film business, both of which are foreign-owned entities. They are larger than Chromaline 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 Chromaline and possess greater resources. The market for the Company's sand blasting products has relatively few competitors, however, those in this market compete aggressively on price and in other areas. Chromaline considers itself to be a significant factor in this market.

## 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.

## EMPLOYEES

As of February 28, 2002, the Company had approximately 70 full-time employees, all of whom are located at the Company's headquarters in Duluth, Minnesota with the exception of one employee located in Lakeville, Minnesota and three outside technical sales representatives in various locations around 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 2. PROPERTY

The Company primarily conducts its operations in Duluth, Minnesota. The administrative, sales, research and development, quality and 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. Shipping and distribution for the Company operates from 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 leases a small lab facility in Lakeville, Minnesota and warehouse space at two locations in Superior, Wisconsin.

## ITEM 3. LEGAL PROCEEDINGS

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders by the registrant during the fourth quarter of the fiscal year covered by this report.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is traded on the Nasdaq SmallCap Market under the symbol CMLH. The following table sets forth, for the fiscal quarters indicated, the high and low bid prices for the Company's Common Stock as reported on both markets for the periods indicated. The quotations reflect inter-dealer prices without retail mark-up, mark-down or commission, and may not represent actual transactions.

<Table>  
<Caption>

	HIGH	LOW
<S>	----	---
	<C>	<C>
FISCAL YEAR ENDED DECEMBER 31, 2001:		
First Quarter.....	\$5.25	\$4.63
Second Quarter.....	5.00	3.25
Third Quarter.....	4.20	3.20
Fourth Quarter.....	3.80	2.62
FISCAL YEAR ENDED DECEMBER 31, 2000:		
First Quarter.....	\$7.50	\$6.00
Second Quarter.....	7.25	4.00
Third Quarter.....	6.44	5.00
Fourth Quarter.....	5.13	4.75

</Table>

As of February 8, 2002, the Company had approximately 450 shareholders of record. The Company has never declared or paid any dividends on its Common Stock. The Company currently intends to retain any earnings for use in its business and therefore does not anticipate paying any dividends in the near future.

ITEM 6. 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 2001 and 2000 and should be read in connection with the Company's audited financial statements and notes thereto for the years ended December 31, 2001 and 2000.

FACTORS THAT MAY AFFECT FUTURE RESULTS

Certain statements made in this Annual Report on Form 10-KSB, including those summarized below, are forward-looking statements within the meaning of the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended, that involve risks and uncertainties, and actual results may differ. Factors that could cause actual results to differ include those identified below.

- o The belief that the Company's new distribution agreement in China will lead to increased sales in that market--This belief may be impacted by economic, political and social conditions in China, the emphasis placed on selling the Company's products by the Chinese distributor and the results of such emphasis, and changes in competitive conditions or other barriers to entry or expansion in the Chinese market.
- o The Company's plans for achieving increased sales in its abrasive etching markets--These plans may be impacted by economic, political and social conditions in domestic or foreign markets, changes in competitive conditions or other barriers to entry or expansion in these markets and delays in the development of new products.
- o The belief that the Company's current financial resources, cash generated from operations and the Company's capacity for debt and/or equity financing will be sufficient to fund current and anticipated business operations and capital expenditures. The belief that the Company's low debt levels and available line of credit make it unlikely that a decrease in product demand would impair the Company's ability to fund operations--Changes in anticipated operating results, credit availability, equity market conditions or the Company's debt levels may further enhance or inhibit the

Company's ability to maintain or raise appropriate levels of cash.

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- o The Company's plans to continue to invest in research and development efforts and the expected focus and results of such efforts--These plans and expectations may be impacted by general market conditions, unanticipated changes in expenses or sales, delays in the development of new products, technological advances or other changes in competitive conditions.
- o The Company's belief that its vulnerability to foreign currency fluctuations and general economic conditions in foreign countries is not significant--This belief may be impacted by economic, political and social conditions in foreign markets and changes in regulatory and competitive conditions or a change in the amount or geographic focus of the Company's international sales.
- o The Company's efforts to grow its international business--These efforts may be impacted by economic, political and social conditions in current and anticipated foreign markets, regulatory conditions in such markets, unanticipated changes in expenses or sales, changes in competitive conditions or other barriers to entry or expansion.
- o The Company's plan to seek acquisitions--This plan may be impacted by general market conditions, competitive conditions in the Company's industry, unanticipated changes in the Company's financial position or the inability to identify attractive acquisition targets.

#### RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 2001 COMPARED TO YEAR ENDED DECEMBER 31, 2000

**Sales.** The Company's net sales increased 3.7% to \$10.8 million in 2001, compared to net sales of \$10.4 million in 2000. Sales in the United States were stable at \$7.5 million. Sales to the screen printing industry in the United States, particularly in the electronics industry, were weak in 2001 due to the domestic economic recession. This weakness was offset by increases in crystal glass sales in the awards and engraving market. Also contributing to the increase in sales was an increase in sales of the Company's PhotoBrasive film products. This was the result of the full re-introduction of film products covered by the Company's patent infringement lawsuit with Aicello that was settled in January 2001. International sales increased 13.6% to \$3.3 million in 2001, reflecting a full year of operation without Chromaline Europe, S.A. ("CESA"), the former European master distributor of the Company's products in which the Company owned a 19.5% interest. CESA filed for bankruptcy in September 2000 and its relationship with the Company was terminated. The Company is now selling directly to those customers previously serviced by CESA. The Company believes this is a significant improvement due to the increased margins associated with these direct sales.

**Cost of Goods Sold.** Cost of goods sold was \$6.2 million, or 57.8% of sales, in 2001 and \$5.5 million, or 52.9% of sales, in 2000. The increase in cost of goods sold was due to a shift in the Company's product mix within its domestic U.S. market. Specifically, there was an increase in crystal glass sales that have lower margins accompanied by a reduction in higher-margin film sales within the screen printing industry due to the domestic economic recession. The increase in cost of goods sold also reflects higher raw material costs, specifically for mylar and resins, as a result of volatile world petroleum prices.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses increased to \$4.1 million, or 38.0% of sales, in 2001 from \$3.8 million, or 36.5% of sales, in 2000. This was due in part to the Company increasing its bad debt allowance by \$68,000 to reflect the risk associated with an increased presence in Europe and India. The Company also incurred \$103,000 in royalty costs pursuant to the license agreement signed with Aicello in January 2001. In addition, the Company evaluated the remaining \$197,000 of goodwill associated with the June 2000 acquisition of Nichols & Associates against its future cash flows and determined that it was impaired. The Company expensed the remaining \$197,000 of this goodwill during 2001. These increases in expenses were partially offset as a result of the culmination of the Aicello litigation in January 2001, as the Company had spent \$169,000 in legal fees on this lawsuit during 2000.

**Research and Development Expenses.** Research and development expenses were \$793,000, or 7.4% of sales, in 2001 compared to \$786,000, or 7.6% of sales, in 2000.

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Interest Income. Interest income decreased to \$35,000 for 2001,

compared to \$61,000 for 2000. The decrease was due in part to the utilization of invested cash resources for an additional \$75,000 investment in Apprise Technologies of Duluth, Minnesota, and a prepaid royalty payment of \$150,000 made to Aicello in February 2001. The decrease also relates to investments in inventory for the Nichols chemical product line, ultraviolet light measuring devices being manufactured by Apprise and sold by Chromaline, and inventory for a dry film product used for photopositive development from an ink jet printer being sold by the Company under the AccuArt label.

Income Taxes. An income tax benefit of \$92,000 was recorded for 2001, for an effective rate of 30.9%, compared to an income tax expense of \$109,000, for an effective rate of 29.9%, for 2000. The difference in the effective rate is due to permanent differences for allowable tax deductions, including foreign sales corporation credits.

#### LIQUIDITY AND CAPITAL RESOURCES

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 \$544,000 and \$71,000 at December 31, 2001 and December 31, 2000, respectively. The Company generated \$356,000 in cash from operating activities during 2001 and \$183,000 during 2000. Cash generated from operating activities is primarily provided by net income or loss, as adjusted for various non-cash items including deferred taxes and depreciation. As described above, during 2001 the Company had a non-cash charge of \$197,000 for the write-off of goodwill associated with the Nichols acquisition that was deemed to be impaired. During 2001, trade receivables decreased by \$166,000 reflecting an increased effort to reduce the number of days that sales are outstanding. Prepaid expenses in 2001 decreased by a moderate \$10,000. Inventories increased by \$80,000 during 2001 reflecting new product launches for the AccuArt film line and the U.V. Minder measuring devices. For 2001, the Company experienced an income tax benefit reflecting its operating loss for the year. While it will receive an income tax refund, it is lower than the refund received in 2000 and is reflected in the \$98,000 decrease in the Company's income tax receivable. Accounts payable decreased by \$62,000 in 2001 reflecting normal variations in spending patterns. Accrued expenses decreased by \$23,000 in 2001 reflecting lower payroll and fringe benefit requirements and legal fees.

The Company provided \$116,000 and used \$686,000 in cash for investing activities during 2001 and 2000, respectively. Net cash used for investing activities was utilized, in part, for plant and equipment. In addition, the Company replaced its business software in 2001. These expenditures amounted to \$259,000 and \$164,000 in 2001 and 2000, respectively. During the first quarter of 2001, the Company sold a portion of its securities holdings to fund the \$150,000 royalty payment to Aicello and an additional investment of \$75,000 in Apprise Technologies. During the fourth quarter of 2001, the Company sold its preferred security stock holdings and purchased general revenue obligation bonds in certain municipalities and school districts. During 2000, the Company purchased preferred stock holdings in certain investment and utility companies. The Company used \$609,000 and \$277,000 in cash for the purchase of these marketable securities during 2001 and 2000, respectively. The Company generated \$1.0 million and \$311,000 in cash from the sale of such marketable securities during 2001 and 2000, respectively. Any unrealized gains or losses are included in other comprehensive income. As described above, the Company increased its interest in Apprise Technologies in 2001 by \$75,000. During 2000, the Company purchased its initial interest in Apprise Technologies, consisting of stock and warrants, for \$112,500. Among other activities, Apprise is conducting research in ultraviolet light technology that complements the markets served by the Company. The interest in Apprise would amount to approximately 6.4% of that company if all warrants were exercised. In June 2000, the Company purchased the assets and assumed a portion of the liabilities of Nichols for \$455,000 cash. Nichols produces an environmentally friendly line of screen preparation and cleaning products that complements the products Chromaline currently sells.

The Company used \$132,000 in cash during 2000 for the repurchase of 26,429 shares of its outstanding common stock under its on-going stock repurchase program. No shares were repurchased during 2001.

A bank line of credit exists providing for borrowings of up to \$1,250,000. Outstanding debt under this line of credit is collateralized by accounts receivable and inventory and bears interest at 2.25 percentage points over the 30-day LIBOR rate. The Company has not utilized this line of credit to a material extent and there was no debt outstanding under this line as of December 31, 2001 or 2000.

The Company believes that current financial resources, cash generated from operations and the Company's capacity for debt and/or equity financing will be sufficient to fund current and anticipated business operations. The Company

also believes that its low debt levels and available line of credit make it unlikely that a decrease in demand for the Company's products would impair the Company's ability to fund operations. Future activities undertaken to expand the Company's business may include acquisitions, building expansion and additions, equipment additions, new product development and marketing opportunities.

#### CAPITAL EXPENDITURES

The Company spent \$259,000 on capital expenditures during 2001. This spending included manufacturing equipment upgrades to improve efficiency and reduce operating costs, building facility upgrades and new vehicles under its rotating replacement policy. The Company also replaced its business software in order to improve internal reporting for decision-making purposes and improve the efficiency of administrative and manufacturing operations.

Commitments for capital expenditures include ongoing manufacturing equipment upgrades, development equipment to modernize the capabilities and processes of Chromaline's laboratory and research and development to improve measurement and quality control processes. These commitments are expected to be less than 2001 capital expenditures and will be funded with cash generated from operating activities.

#### INTERNATIONAL ACTIVITY

The Company markets its products to over 50 countries in North America, Europe, Latin America, Asia and other parts of the world. Foreign sales were approximately 30% and 27% of total sales during 2001 and 2000, respectively. Foreign sales in 2001 reflected higher sales to the European region subsequent to the liquidation of Chromaline Europe, S.A. (CESA). This opened up the European market for direct sales by the Company to those customers formerly served by CESA. Foreign sales in 2000 were impacted by strong competitive forces resulting in lower selling prices. Fluctuations of certain foreign currencies have not significantly impacted the Company's operations because the Company's foreign sales are not concentrated in any one region of the world. The Company believes its vulnerability to uncertainties due to foreign currency fluctuations and general economic conditions in foreign countries is not significant.

Substantially all of the Company's foreign transactions are negotiated, invoiced and paid in U.S. dollars. A portion of the Company's foreign sales are invoiced and paid in Eurodollars. Chromaline has not implemented a 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 as of December 31, 2001.

#### FUTURE OUTLOOK

Chromaline has invested over 6% of its sales dollars for the past several years in research and development. The Company plans to maintain its efforts in this area and expedite internal product development as well as form technological alliances with outside experts to ensure commercialization of new product opportunities.

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.

In January 2001, the Company formed a marketing alliance with The Slee Corporation of Chicago, Illinois. Under the terms of the agreement, the Company's PhotoBrasive Systems division becomes a "Master Distributor" of Slee's Crystal Edge Recognition series of glass and crystal products. Slee is the industry leader in crystal recognition products world-wide and will continue to market and sell its products through its organization. This arrangement enhances the Company's product offerings as a one-stop purchasing option for its customers.

During 1999, the Company began evaluating potential acquisitions. In June 2000, the Company purchased the assets and assumed certain liabilities of Nichols. Nichols produces an environmentally friendly line of screen preparation and cleaning products that fully complements the products offered by Chromaline. This new line of products broadens the market offerings to the screen printing industry. The Company plans to continue to look for opportunities that complement its existing business and technologies. The search and evaluation process continues to proceed in a cautious and prudent manner. The Company's goal is to capitalize on its strong cash and low debt positions as well as the strengths of the Company's core businesses in order to grow shareholder value.

In October 2001, the Company entered into a strategic alliance and distribution agreement with Digital IMS of Lincoln, Nebraska. Digital IMS has developed a point-of-sale web site for businesses to use to manage their customer and distribution network. Chromaline is actively marketing this product



into the screen printing industry.

#### ACCOUNTING PRONOUNCEMENTS

On January 1, 2001, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that all derivatives, including those embedded in other contracts, be recognized as either assets or liabilities and that those financial instruments be measured at fair value. The accounting for changes in the fair value of derivatives depends on their intended use and designation. Management has reviewed the requirements of SFAS No. 133 and has determined that the Company has no free-standing or embedded derivatives. All agreements that contain provisions meeting the definition of a derivative also meet the requirements of, and have been designated as, normal purchases or sales. The Company's policy is to not use free-standing derivatives and to not enter into contracts with terms that cannot be designated as normal purchases or sales.

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 142, Goodwill and Other Intangible Assets. Under SFAS No. 142, goodwill as well as other intangibles determined to have an indefinite life will no longer be amortized after December 31, 2001; however, these assets must be reviewed for impairment at least annually. As of December 31, 2001, the Company did not have any goodwill or other intangibles with an indefinite life. As such, the Company does not expect the adoption of SFAS No. 142 to have a material impact on its operating results and financial condition.

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#### ITEM 7. FINANCIAL STATEMENTS

##### INDEPENDENT AUDITORS' REPORT

Stockholders and Board of Directors  
The Chromaline Corporation

We have audited the accompanying balance sheets of The Chromaline Corporation (the Company) as of December 31, 2001 and 2000 and the related statements of earnings, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Chromaline Corporation as of December 31, 2001 and 2000 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.

/s/ Deloitte & Touche LLP

Minneapolis, Minnesota  
February 6, 2002

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#### THE CHROMALINE CORPORATION

BALANCE SHEETS  
DECEMBER 31, 2001 AND 2000

<Table>  
<Caption>

2001

2000

<u>&lt;S&gt;</u>	<u>&lt;C&gt;</u>	<u>&lt;C&gt;</u>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents .....	\$ 543,679	\$ 71,493
Marketable securities .....	237,154	664,156
Trade receivables, less allowance for doubtful accounts of \$100,000 and \$32,400, respectively .....	1,472,982	1,639,046
Inventories .....	1,605,670	1,525,993
Prepaid expenses and other assets .....	118,178	128,369
Income tax refund receivable .....	133,030	231,110
Deferred taxes (Note 4) .....	68,000	59,000
	-----	-----
Total current assets .....	4,178,693	4,319,167
PROPERTY, PLANT, AND EQUIPMENT, at cost:		
Land and building .....	1,355,588	1,333,787
Machinery and equipment .....	2,189,159	2,389,498
Office equipment .....	1,036,077	635,590
Vehicles .....	223,265	241,631
	-----	-----
	4,804,089	4,600,506
Less accumulated depreciation .....	3,501,330	3,191,974
	-----	-----
	1,302,759	1,408,532
PATENT, net of amortization of \$32,788 and \$23,965, respectively .....		
	76,490	85,502
GOODWILL, net of amortization .....		
		211,214
NONCOMPETE AGREEMENT, net of amortization of \$10,000 and \$3,334, respectively .....		
	90,000	96,666
DEFERRED TAXES (Note 4) .....		
	213,000	105,000
OTHER .....		
	187,500	112,500
	-----	-----
	\$6,048,442	\$6,338,581
	=====	=====

</Table>

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<u>&lt;S&gt;</u>	<u>&lt;C&gt;</u>	<u>&lt;C&gt;</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
CURRENT LIABILITIES:		
Accounts payable	\$ 297,556	\$ 359,081
Accrued compensation	143,338	167,075
Other accrued expenses	27,508	26,488
	-----	-----
-		
Total current liabilities	468,402	552,644
CONTINGENCIES (Note 2)		
STOCKHOLDERS' EQUITY:		
Preferred stock, par value \$.10 per share; authorized 250,000 shares; issued none		
Common stock, par value \$.10 per share; authorized 4,750,000 shares; issued and outstanding 1,271,627	127,163	127,163
Additional paid-in capital	1,293,460	1,293,460
Retained earnings	4,170,246	4,376,147
Accumulated other comprehensive loss	(10,829)	(10,833)
	-----	-----
-		
Total stockholders' equity	5,580,040	5,785,937
	-----	-----
-		
	\$ 6,048,442	\$ 6,338,581
	=====	=====

</Table>

See notes to financial statements.

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STATEMENTS OF OPERATIONS  
YEARS ENDED DECEMBER 31, 2001 AND 2000

<Table>  
<Caption>

	2001	2000
	<C>	<C>
SALES .....	\$ 10,752,133	\$ 10,367,270
COSTS AND EXPENSES:		
Cost of goods sold .....	6,209,505	5,488,267
Selling, general, and administrative .....	4,081,635	3,790,149
Research and development .....	793,484	785,969
	-----	-----
	11,084,624	10,064,385
	-----	-----
(LOSS) INCOME FROM OPERATIONS .....	(332,491)	302,885
INTEREST INCOME .....	34,590	61,122
	-----	-----
(LOSS) INCOME BEFORE INCOME TAXES .....	(297,901)	364,007
FEDERAL AND STATE INCOME TAXES (BENEFIT) (Note 4) ...	(92,000)	109,000
	-----	-----
NET (LOSS) INCOME .....	\$ (205,901)	\$ 255,007
	=====	=====
(LOSS) EARNINGS PER SHARE:		
Basic .....	\$ (0.16)	\$ 0.20
	=====	=====
Diluted .....	\$ (0.16)	\$ 0.20
	=====	=====
WEIGHTED AVERAGE COMMON SHARES		
ASSUMED OUTSTANDING:		
Basic .....	1,271,627	1,295,239
	=====	=====
Diluted .....	1,271,627	1,301,311
	=====	=====

</Table>

See notes to financial statements.

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THE CHROMALINE CORPORATION

STATEMENTS OF STOCKHOLDERS' EQUITY

<Table>  
<Caption>

	COMMON STOCK		ADDITIONAL PAID-IN	RETAINED	ACCUMULATED OTHER COMPREHENSIVE INCOME
TOTAL	SHARES	AMOUNT	CAPITAL	EARNINGS	(LOSS)
EQUITY					
	<C>	<C>	<C>	<C>	<C>
BALANCE AT DECEMBER 31, 1999	1,298,056	\$129,806	\$1,320,416	\$4,223,108	\$ (11,855)
\$5,661,475					
Net income				255,007	
255,007					
Unrealized loss on available-for-sale investments					1,022
1,022					
-----					
Total comprehensive income					
256,029					
Repurchase of 26,429 shares of common stock	(26,429)	(2,643)	(26,956)	(101,968)	
(131,567)					
	-----	-----	-----	-----	-----
BALANCE AT DECEMBER 31, 2000	1,271,627	127,163	1,293,460	4,376,147	(10,833)

5,785,937

Net loss				(205,901)	
(205,901)					
Unrealized gain on available-for-sale investments					4
4					
-----					
Total comprehensive income					
(205,897)					
-----					
BALANCE AT DECEMBER 31, 2001	1,271,627	\$127,163	\$1,293,460	\$4,170,246	\$ (10,829)
\$5,580,040					
=====					

</Table>

See notes to financial statements.

THE CHROMALINE CORPORATION

STATEMENTS OF CASH FLOWS  
YEARS ENDED DECEMBER 31, 2001 AND 2000

<Table>  
<Caption>

	2001	2000
	<C>	<C>
<S>		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	\$ (205,901)	\$ 255,007
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	382,045	435,082
Writeoff of goodwill	196,647	
Noncash charge - Chromaline Europe investment		53,997
(Gain) loss on disposal of assets	(10,172)	202
Deferred income taxes	(117,000)	(92,000)
Changes in working capital components:		
(Increase) decrease in:		
Trade receivables	166,064	41,772
Prepaid expenses and other assets	10,191	(46,705)
Inventories	(79,677)	(218,604)
Income taxes refund receivable	98,080	(231,110)
(Decrease) increase in:		
Accounts payable	(61,525)	101,726
Accrued expenses	(22,717)	(34,189)
Accrued legal costs		(27,813)
Income taxes payable		(54,838)
	-----	-----
Net cash provided by operating activities	356,035	182,527
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(259,230)	(164,174)
Proceeds on sale of property and equipment	23,375	26,827
Purchases of marketable securities	(609,386)	(277,073)
Proceeds from sale of marketable securities	1,036,392	311,399
Purchase of investments	(75,000)	(127,765)
Purchase of assets net of liabilities assumed		(455,026)
	-----	-----
Net cash used in investing activities	116,151	(685,812)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repurchase of company stock		(131,567)
	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	472,186	(634,852)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	71,493	706,345
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 543,679	\$ 71,493
	=====	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION -		
Cash paid for income taxes	\$ 57,133	\$ 394,948
	=====	=====

</Table>

See notes to financial statements.

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THE CHROMALINE CORPORATION

NOTES TO FINANCIAL STATEMENTS  
YEARS ENDED DECEMBER 31, 2001 AND 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business - The Chromaline Corporation (the Company) develops and manufactures high-quality photochemical imaging systems for sale primarily to a wide range of printers and decorators of surfaces. Customers' applications include textiles, billboards, electronics, glassware, fine china, and many other industrial and commercial applications. The Company's principal markets are throughout the United States. In addition, the Company sells to Western 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.

Forty percent and forty-one percent, respectively, of the Company's accounts receivable at December 31, 2001 and 2000 are due from foreign customers. The foreign receivables are composed primarily of open credit arrangements with terms ranging from 45 to 90 days. No receivable from a single unrelated customer exceeded 10% of total accounts receivable at December 31, 2001 and 2000, and no single customer represented greater than 10% of total revenue in 2001 or 2000.

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 carrying value approximates market value because of the short maturity of these instruments.

Marketable Securities - Marketable securities are classified as available-for-sale securities and consist primarily of municipal revenue bonds and preferred stock that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity, or changes in the availability or yield of alternative investments. These securities are carried at fair market value with changes in fair value recorded in comprehensive income.

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 cost method had been used, inventories would have been approximately \$212,000 and \$190,000 higher than reported at December 31, 2001 and 2000, respectively. The major components of inventory are as follows:

<Table>  
<Caption>

	2001	2000
<S>	<C>	<C>
Raw materials	\$ 638,424	\$ 550,340
Work-in-progress	236,493	326,266
Finished goods	942,301	839,507
Reduction to LIFO cost	(211,548)	(190,120)
	-----	-----
Total inventory	\$ 1,605,670	\$ 1,525,993
	=====	=====

</Table>

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Depreciation - Depreciation of property and equipment is computed using the straight-line method over the following estimated useful lives:

<Table>  
<Caption>

<S>	Years
	<C>

Building	25
Machinery and equipment	5
Office equipment	5
Vehicles	3

</Table>

Goodwill - Goodwill represents the excess of the purchase price and related costs over the fair value of the net assets of the business acquired. Goodwill was being amortized on a straight-line basis over 15 years. As described in Note 5, the Company determined its goodwill was impaired and wrote down the remainder of the goodwill in fiscal 2001.

Noncompete Agreement - The Company's policy is to amortize the asset using the straight-line method over the term of the agreement.

Other Assets - Other assets consist of a \$187,500 investment in Apprise Technologies, Inc. This investment is accounted for on the cost method. One of the Company's directors is the CEO of Apprise Technologies, Inc.

Patent - The Company purchased a patent in 1998 for \$109,467. Amortization of the patent is computed using the straight-line method over its remaining estimated useful life of 12 years.

Impairment of Long-Lived Assets - Management periodically reviews the carrying value of long-term assets for potential impairment by comparing the carrying value of these assets to the estimated undiscounted future cash flows expected to result from the use of these assets. Should the sum of the related, expected future net cash flows be less than the carrying value, an impairment loss would be measured. An impairment loss would be measured by the amount by which the carrying value of the asset exceeds the fair value of the asset with fair value being determined using discounted cash flows. To date, other than the goodwill impairment discussed in Note 5, management has determined that no other impairment of these assets exists.

Revenue Recognition - The Company recognizes revenue on products when title passes, which is usually upon shipment. Freight billed to customers is included in sales.

Income Taxes - Deferred income taxes are provided on an asset and liability method. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Comprehensive Income - The Company's comprehensive income consists of net income and unrealized holding gains and losses on marketable securities.

Earnings Per Common Share (EPS) - Basic EPS is calculated using net income divided by the weighted average of common shares outstanding during the year. Diluted EPS is similar to Basic except that the weighted average of common shares outstanding is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares, such as options, had been issued.

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

<Table>		
<Caption>		
<S>	2001	2000
	<C>	<C>
Weighted average common shares outstanding	1,271,627	1,295,239
Dilutive effect of stock options		6,072
	-----	-----
Weighted average common and common equivalent shares outstanding	1,271,627	1,301,311
	=====	=====
</Table>		

Options to purchase 144,075 and 72,400 shares of common stock were outstanding during the years ended December 31, 2001 and 2000, respectively, but were excluded from the computation of common stock equivalents because they were antidilutive.

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.

Stock Options - As described in Note 8, the Company has adopted only the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation. Stock options have been granted to employees and board members and continue to be accounted for under Accounting Principles Board (APB) Opinion No. 25.

Foreign Operations - The Company markets in Europe, Latin America, Asia, and other parts of the world. Foreign sales approximated 30% and 27% of total sales in 2001 and 2000, respectively.

In December 1996, the Company purchased a 19.5% interest in Chromaline Europe, S.A., a French corporation. On January 2, 1997, the Company sold the assets of the French representative office to Chromaline Europe, S.A for an amount that approximated cost. This investment was accounted for at cost. In fiscal 2000, Chromaline Europe, S.A. filed bankruptcy causing the Company to write off the \$53,997 investment and \$95,000 in receivables due from Chromaline Europe, S.A. In 2000, less than 10% of total sales were made to Chromaline Europe, S.A.

Line of Credit - The Company has a \$1,250,000 bank line of credit that provides for working capital financing. This line of credit is subject to annual renewal on each May 1, is collateralized by trade receivables and inventory, and bears interest at 2.25% points over 30-day LIBOR. There was no outstanding balance at December 31, 2001 and 2000.

Reclassification - Certain reclassifications were made to the 2000 financial statements to conform to the 2001 presentation. These reclassifications had no impact on net income or stockholders' equity as previously reported.

Accounting Pronouncements - On January 1, 2001, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that all derivatives, including those embedded in other contracts, be recognized as either assets or liabilities and that those financial instruments be measured at fair value. The accounting for changes in the fair value of derivatives depends on their intended use and designation. Management has reviewed the requirements of SFAS No. 133 and has determined that they have no free-standing or embedded derivatives. All agreements that contain provisions meeting the definition of a derivative also meet the requirements of, and have been designated as, normal purchases or sales. The Company's policy is to not use free-standing derivatives and to not enter into contracts with terms that cannot be designated as normal purchases or sales.

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 142, Goodwill and Other Intangible Assets. Under SFAS No. 142, goodwill as well as other intangibles determined to have an

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indefinite life will no longer be amortized after December 31, 2001; however, these assets must be reviewed for impairment at least annually. As of December 31, 2001, the Company did not have any goodwill or other intangibles with an indefinite life. As such, the Company does not expect the adoption of SFAS No. 142 to have a material impact on its operating results and financial condition.

## 2. CONTINGENCIES

The Company was a defendant in a claim filed in the United States District Court, Western District of Washington at Seattle, in which the claimant alleged that certain of the Company's products infringe on two U.S. patents owned by the claimant. During the years ended December 31, 2001 and 2000, approximately \$112,000 and \$169,000 were charged to expense related to this matter.

Based upon a settlement agreement reached in January 2001, the plaintiff dismissed the suit. In connection with this settlement, the Company entered into a license agreement and agreed to pay royalties primarily based on future sales of products subject to the license agreement. The license agreement also requires the Company to prepay minimum royalty payments on February 1, 2001 and June 1, 2002 for \$150,000 and \$125,000, respectively. The first royalty payment covers sales from February 1, 2001 through May 31, 2002, while the second covers sales from June 1,

2002 through May 31, 2003. Payments are amortized over the appropriate period.

3. STOCKHOLDERS' EQUITY

During the year ended December 31, 2000, the Company repurchased 26,429 shares of its common stock for \$131,567, which shares now constitute authorized but unissued shares. The Company did not repurchase any shares during the year ended December 31, 2001.

4. INCOME TAXES

Income tax (benefit) expense for the years ended December 31, 2001 and 2000 consists of the following:

<Table>  
<Caption>

	2001	2000
<S>	<C>	<C>
Current:		
Federal	\$ 26,600	\$ 196,000
State	(1,600)	5,000
	-----	-----
Deferred	25,000	201,000
	(117,000)	(92,000)
	-----	-----
	\$ (92,000)	\$ 109,000
	=====	=====

</Table>

The expected provision for income taxes, computed by applying the U.S. federal income tax rate of 35% to income before taxes, is reconciled to income tax (benefit) expense as follows:

<Table>  
<Caption>

	2001	2000
<S>	<C>	<C>
Expected provision for federal income taxes	\$ (101,000)	\$ 127,500
State income taxes	(1,600)	13,500
Foreign sales corporation	5,300	(26,500)
Meals and entertainment	11,600	11,500
Other	(6,300)	(17,000)
	-----	-----
	\$ (92,000)	\$ 109,000
	=====	=====

</Table>

Deferred tax assets consist of the following as of December 31, 2001 and 2000:

<Table>  
<Caption>

	2001	2000
<S>	<C>	<C>
Property and equipment and other assets	\$ 86,000	\$ 105,000
Accrued vacation	24,000	24,000
Inventory	49,000	12,000
Allowance for doubtful accounts	37,000	12,000
Allowance for sales returns	7,000	8,000
Intangible assets	73,000	
Capital loss carryforward	20,000	20,000
Other	5,000	3,000
Valuation allowance	(20,000)	(20,000)
	-----	-----
	\$ 281,000	\$ 164,000
	=====	=====

</Table>

5. ASSET PURCHASE AND NONCOMPETE AGREEMENT

In June 2000, the Company acquired certain assets and assumed certain liabilities of Nichols & Associates. The acquisition was accounted for under the purchase method of accounting. Accordingly, the assets acquired and liabilities assumed were recorded at their estimated fair values. The excess of the purchase price over the estimated fair value of the tangible and other assets acquired was recorded as goodwill and was being amortized on a straight-line basis over 15 years. Included with the asset purchase was a noncompete agreement entered into by the



Company and the owners of Nichols & Associates. Assets acquired, liabilities assumed, and cash consideration paid were as follows:

<Table>	
<S>	
Assets acquired:	<C>
Accounts receivable	\$ 109,736
Inventory	31,358
Property and equipment	65,665
Goodwill	218,497
Noncompete agreement	100,000
	-----
	525,256
Liabilities assumed -	
Accounts payable	70,230
	-----
Cash consideration paid	\$ 455,026
	=====

</Table>

If the acquisition had occurred on January 1, 1999, the pro forma impact on revenues would have been to increase revenues by approximately \$300,000 for the year ended December 31, 2000. The pro forma impact on net income and earnings per share is not material. In accordance with SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, the Company evaluated the net book value of the recorded goodwill against the estimated future cash flows for the Nichols division and determined the goodwill was impaired and thus written off during the year ended December 31, 2001.

6. PENSION PLAN

The Company has a defined contribution pension plan which covers substantially all of its employees. The Company contributes an amount equal to five percent of a covered employee's compensation. Total pension expense for the years ended December 31, 2001 and 2000 was approximately \$138,000 and \$132,000, respectively.

7. GEOGRAPHIC INFORMATION

The Company manages and operates its business on the basis of one reportable segment. See Note 1 for a brief description of the Company's business. As of December 31, 2001, the Company had operations established in various countries throughout the world. The Company is exposed to the risk of changes in social, political, and economic conditions inherent in foreign operations, and the Company's results of

operations are affected by fluctuations in foreign currency exchange rates. No single foreign country accounted for more than 10% of the Company's net sales for 2001 and 2000. Net sales by geographic area are presented by attributing revenues from external customers on the basis of where the products are sold.

<Table>	
<Caption>	
<S>	<C>
	2001
	2000
Net sales by geographic area:	
United States	\$ 7,526,493
International	3,225,640
	-----
	\$ 10,752,133
	=====

</Table>

8. STOCK OPTIONS

During 1995, the Company adopted a stock incentive plan for the issuance of up to 38,500 shares of common stock. In 1999, the Company increased the number of shares reserved for issuance under this plan to 203,500 shares. The plan provides for granting eligible participants stock options or other stock awards, as described by the plan, at option prices ranging from 85% to 110% of fair market value at date of grant. Options granted expire up to ten years after the date of grant. Such options generally become exercisable over a one- to three-year period.

The Company has adopted the disclosure provisions of SFAS No. 123 and has continued to apply APB Opinion No. 25 and related interpretation in accounting for its plan. Accordingly, no compensation cost has been recognized for its plan. Had compensation cost for the Company's

stock-based compensation plans been determined based on the fair value at the grant dates as calculated in accordance with SFAS No. 123, the Company's net income and earnings per share for the years ended December 31, 2001 and 2000 would have been reduced to the pro forma amounts indicated below:

	2001	2000
Net (loss) income:		
As reported	\$ (205,901)	\$ 255,007
Pro forma	(324,959)	168,178
Net (loss) income per share (basic):		
As reported	(0.16)	0.20
Pro forma	(0.26)	0.13
Net (loss) income per share (diluted):		
As reported	(0.16)	0.20
Pro forma	(0.26)	0.13

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions and results:

	2001	2000
Dividend yield	0.0%	0.0%
Expected volatility	74.4%	69.3%
Expected life of option	five years	five years
Risk-free interest rate	4.7%	6.4%
Fair value of each option on grant date	\$ 2.91	\$ 3.80

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A summary of the status of the Company's stock option plan as of December 31, 2001 and 2000 and changes during the years ending on those dates is presented below:

	2001		2000	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	89,450	\$7.13	85,279	\$7.54
Granted	55,125	4.66	38,000	6.58
Exercised				
Expired	(1,655)	5.45	(33,829)	7.56
Outstanding at end of year	142,920	6.20	89,450	7.13

The following table summarizes information about stock options outstanding at December 31, 2001:

Range of Exercise Price	Options Outstanding			Options Exercisable		
	Number Outstanding at December 31, 2001	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at December 31, 2001	Weighted-Average Exercise Price	
\$ 3.67	13,750	3.32	\$3.67			
4.60	48,125	4.31	4.60			
5.06 - 5.25	9,475	4.49	5.10			
6.56	29,500	3.32	6.56	15,155	\$6.56	
7.22 - 7.84	8,300	3.78	7.47	6,100	7.33	
8.18	20,750	4.32	8.18	6,851	8.18	
9.00 - 9.20	13,200	4.96	9.15	4,400	9.15	

&lt;/Table&gt;

## ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

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## PART III

## ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

The information included in the Company's definitive proxy statement for the 2002 Annual Meeting of Shareholders under the captions "Election of Directors", "Executive Officers" and "Section 16(a) Beneficial Ownership Reporting Compliance" is incorporated by reference.

## ITEM 10. EXECUTIVE COMPENSATION

The information included in the Company's definitive proxy statement for the 2002 Annual Meeting of Shareholders under the captions "Election of Directors--Director Compensation", "Summary Compensation Table", "Option Grants in Last Fiscal Year", "Aggregate Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values" and "Employment Contracts; Termination of Employment and Change-In-Control Arrangements" is incorporated by reference.

## ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information included in the Company's definitive proxy statement for the 2002 Annual Meeting of Shareholders under the caption "Security Ownership of Principal Shareholders and Management" is incorporated by reference.

## ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Not applicable.

## ITEM 13. EXHIBITS, AND REPORTS ON FORM 8-K

(a) The following exhibits are filed as part of this Annual Report on Form 10-KSB for the fiscal year ended December 31, 2001:

&lt;Table&gt;

&lt;Caption&gt;

Exhibit

Description

-----

-----

<S>	<C>
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 Registration Statement on Form 10-SB filed with the Commission on April 7, 1999 (Registration 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	The Chromaline Corporation 1995 Stock Incentive Plan, 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).)
10.5	Revolving Credit Agreement dated April 30, 1999 between the Company and M&I Bank. (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).)

23 Consent of Deloitte & Touche LLP.

24 Powers of Attorney.

&lt;/Table&gt;

(b) Reports on Form 8-K: No reports on Form 8-K were filed by the registrant during the fourth quarter of the fiscal year ended December 31, 2001.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on March 22, 2002.

THE CHROMALINE CORPORATION

By /s/ William C. Ulland
-----
William C. Ulland, Chairman, Chief Executive Officer and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 22, 2002.

/s/ William C. Ulland
-----
William C. Ulland, Chairman, Chief Executive Officer and President
(Principal Executive Officer)

/s/ Jeffery A. Laabs
-----
Jeffery A. Laabs, Chief Financial Officer, Treasurer and Secretary
(Principal Financial and Accounting Officer)

- Charles H. Andresen\* Director
Rondi Erickson\* Director
H. Leigh Severance\* Director
Gerald W. Simonson\* Director
David O. Harris\* Director

\* William C. Ulland, by signing his name hereto, does hereby sign this document on behalf of each of the above named Directors of the registrant pursuant to powers of attorney duly executed by such persons.

/s/ William C. Ulland
-----
William C. Ulland, Attorney-in-Fact

INDEX TO EXHIBITS

<Table>
<Caption>
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-----
<S> <C>
3.1 Restated Articles of Incorporation of Company, as amended..... Incorporated by Reference
3.2 By-Laws of the Company, as amended..... Incorporated by Reference
4 Specimen of Common Stock Certificate..... Incorporated by Reference
10.1 The Chromaline Corporation 1995 Stock Incentive Plan, as amended..... Incorporated by Reference
10.5 Revolving Credit Agreement dated April 30, 1999 between the Company and M&I Bank..... Incorporated by Reference
23 Consent of Deloitte & Touche LLP..... Filed Electronically
24 Powers of Attorney..... Filed Electronically
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CONSENT OF INDEPENDENT AUDITORS'

We consent to the incorporation by reference in Registration Statement No. 333-92893 of The Chromaline Corporation on Form S-8 of our report dated February 6, 2002, appearing in this Annual Report on Form 10-KSB of The Chromaline Corporation for the year ended December 31, 2001.

/s/ Deloitte & Touche LLP

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Minneapolis, Minnesota  
March 22, 2002

THE CHROMALINE CORPORATION

Power of Attorney  
of Director and/or Officer

The undersigned director and/or officer of The Chromaline Corporation, a Minnesota corporation, does hereby make, constitute and appoint William C. Ulland and Jeffery A. Laabs, 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 and/or officer of said Corporation to an Annual Report on Form 10-KSB 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, the undersigned has hereunto set the undersigned's hand this 5th day of February, 2002.

/s/ Charles H. Andresen  
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Charles H. Andresen

THE CHROMALINE CORPORATION

Power of Attorney  
of Director and/or Officer

The undersigned director and/or officer of The Chromaline Corporation, a Minnesota corporation, does hereby make, constitute and appoint William C. Ulland and Jeffery A. Laabs, 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 and/or officer of said Corporation to an Annual Report on Form 10-KSB 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, the undersigned has hereunto set the undersigned's hand this 7th day of February, 2002.

/s/ Rondi Erickson  
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Rondi Erickson

THE CHROMALINE CORPORATION

Power of Attorney  
of Director and/or Officer

The undersigned director and/or officer of The Chromaline Corporation, a Minnesota corporation, does hereby make, constitute and appoint William C. Ulland and Jeffery A. Laabs, 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 and/or officer of said Corporation to an Annual Report on Form 10-KSB 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, the undersigned has hereunto set the undersigned's hand this 15th day of February, 2002.

/s/ David O. Harris

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David O. Harris

THE CHROMALINE CORPORATION

Power of Attorney  
of Director and/or Officer

The undersigned director and/or officer of The Chromaline Corporation, a Minnesota corporation, does hereby make, constitute and appoint William C. Ulland and Jeffery A. Laabs, 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 and/or officer of said Corporation to an Annual Report on Form 10-KSB 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, the undersigned has hereunto set the undersigned's hand this 10th day of February, 2002.

/s/ H. Leigh Severance

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H. Leigh Severance

THE CHROMALINE CORPORATION

Power of Attorney  
of Director and/or Officer

The undersigned director and/or officer of The Chromaline Corporation, a Minnesota corporation, does hereby make, constitute and appoint William C. Ulland and Jeffery A. Laabs, 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 and/or officer of said Corporation to an Annual Report on Form 10-KSB 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, the undersigned has hereunto set the undersigned's hand this 22nd day of February, 2002.

/s/ Gerald W. Simonson

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Gerald W. Simonson