

**U.S. SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

**For the Quarterly Period Ended September 30, 2019**

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)

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

**Not Applicable**  
(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$.10 per share	IKNX	Nasdaq Capital Market

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 every Interactive Data File required to be submitted 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 such files.) Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the 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   
Non-accelerated filer

Accelerated filer   
Smaller reporting company   
Emerging growth 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, \$.10 par value - 1,976,354 shares outstanding as of November 1, 2019.

**IKONICS CORPORATION**  
QUARTERLY REPORT ON FORM 10-Q

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**PART I - FINANCIAL INFORMATION****ITEM 1. Condensed Financial Statements****IKONICS CORPORATION  
CONDENSED BALANCE SHEETS**

	<b>September 30, 2019</b>	<b>December 31, 2018</b>
	(unaudited)	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 758,739	\$ 1,623,137
Short-term investments	2,450,000	2,695,000
Trade receivables, less allowance of \$53,000 in 2019 and 2018	2,211,440	2,215,215
Inventories	2,573,441	2,046,588
Prepaid expenses and other assets	952,854	375,362
Income taxes receivable	—	2,768
Total current assets	<u>8,946,474</u>	<u>8,958,070</u>
<b>PROPERTY, PLANT, AND EQUIPMENT, at cost:</b>		
Land and building	9,503,733	9,500,429
Machinery and equipment	5,192,854	4,964,816
Office equipment	1,604,981	1,559,728
Vehicles	245,674	245,679
	<u>16,547,242</u>	<u>16,270,652</u>
Less accumulated depreciation	(8,612,986)	(8,185,910)
Total property, plant and equipment at cost, net	<u>7,934,256</u>	<u>8,084,742</u>
INTANGIBLE ASSETS, less accumulated amortization of \$175,049 in 2019 and \$149,740 in 2018	281,504	376,406
Total assets	<u>\$ 17,162,234</u>	<u>\$ 17,419,218</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Current portion of long-term debt	\$ 132,458	\$ 129,282
Accounts payable	772,520	647,528
Accrued compensation	256,426	366,900
Other accrued liabilities	944,489	159,821
Total current liabilities	<u>2,105,893</u>	<u>1,303,531</u>
<b>LONG-TERM LIABILITIES</b>		
Long-term debt, less current portion	2,722,063	2,821,657
Deferred income taxes	—	183,000
Total long-term liabilities	<u>2,722,063</u>	<u>3,004,657</u>
Total liabilities	<u>4,827,956</u>	<u>4,308,188</u>
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY</b>		
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 1,976,354 shares in 2019 and 1,983,553 in 2018.	197,635	198,355
Additional paid-in-capital	2,719,471	2,723,024
Retained earnings	9,417,172	10,189,651
Total stockholders' equity	<u>12,334,278</u>	<u>13,111,030</u>
Total liabilities and stockholders' equity	<u>\$ 17,162,234</u>	<u>\$ 17,419,218</u>

See notes to condensed financial statements.

**IKONICS CORPORATION**  
**CONDENSED STATEMENTS OF OPERATIONS (Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
NET SALES	\$ 4,530,361	\$ 4,651,358	\$ 12,655,463	\$ 13,357,013
COST OF GOODS SOLD	3,118,299	3,124,539	8,805,853	8,805,460
GROSS PROFIT	1,412,062	1,526,819	3,849,610	4,551,553
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	1,347,404	1,368,845	4,068,230	4,026,791
RESEARCH AND DEVELOPMENT EXPENSES	218,467	179,915	667,774	490,463
(LOSS) INCOME FROM OPERATIONS	(153,809)	(21,941)	(886,394)	34,299
INTEREST EXPENSE	(22,799)	(23,298)	(67,589)	(67,040)
OTHER INCOME	16,225	13,760	49,722	34,986
(LOSS) INCOME BEFORE INCOME TAXES	(160,383)	(31,479)	(904,261)	2,245
INCOME TAX EXPENSE (BENEFIT)	2,361	(6,727)	(170,775)	12,399
NET LOSS	<u>\$ (162,744)</u>	<u>\$ (24,752)</u>	<u>\$ (733,486)</u>	<u>\$ (10,154)</u>
LOSS PER COMMON SHARE				
Basic	<u>\$ (0.08)</u>	<u>\$ (0.01)</u>	<u>\$ (0.37)</u>	<u>\$ (0.01)</u>
Diluted	<u>\$ (0.08)</u>	<u>\$ (0.01)</u>	<u>\$ (0.37)</u>	<u>\$ (0.01)</u>
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING				
Basic	<u>1,978,926</u>	<u>1,983,553</u>	<u>1,981,568</u>	<u>1,983,553</u>
Diluted	<u>1,978,926</u>	<u>1,983,553</u>	<u>1,981,568</u>	<u>1,983,553</u>

See notes to condensed financial statements.

## IKONICS CORPORATION

STATEMENTS OF STOCKHOLDERS' EQUITY  
THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2019 and 2018 (unaudited)

## For the three months ended September 30, 2019:

	Common Stock		Additional Paid-in Capital	Retained Earnings	Total Stock- holders' Equity
	Shares	Amount			
BALANCE AT JUNE 30, 2019	1,980,811	\$ 198,081	\$ 2,723,099	\$ 9,601,979	\$ 12,523,159
Net loss	—	—	—	(162,744)	(162,744)
Common stock repurchased	(4,457)	(446)	(6,118)	(22,063)	(28,627)
Stock based compensation	—	—	2,490	—	2,490
BALANCE AT SEPTEMBER 30, 2019	<u>1,976,354</u>	<u>\$ 197,635</u>	<u>\$ 2,719,471</u>	<u>\$ 9,417,172</u>	<u>\$ 12,334,278</u>

## For the three months ended September 30, 2018:

	Common Stock		Additional Paid-in Capital	Retained Earnings	Total Stock- holders' Equity
	Shares	Amount			
BALANCE AT JUNE 30, 2018	1,983,553	\$ 198,355	\$ 2,715,863	\$ 10,064,784	\$ 12,979,002
Net loss	—	—	—	(24,752)	(24,752)
Stock based compensation	—	—	3,581	—	3,581
BALANCE AT SEPTEMBER 30, 2018	<u>1,983,553</u>	<u>\$ 198,355</u>	<u>\$ 2,719,444</u>	<u>\$ 10,040,032</u>	<u>\$ 12,957,831</u>

## For the nine months ended September 30, 2019:

	Common Stock		Additional Paid-in Capital	Retained Earnings	Total Stock- holders' Equity
	Shares	Amount			
BALANCE AT DECEMBER 31, 2018	1,983,553	\$ 198,355	\$ 2,723,024	\$ 10,189,651	\$ 13,111,030
Net loss	—	—	—	(733,486)	(733,486)
Common stock repurchased	(7,199)	(720)	(9,883)	(38,993)	(49,596)
Stock based compensation	—	—	6,330	—	6,330
BALANCE AT SEPTEMBER 30, 2019	<u>1,976,354</u>	<u>\$ 197,635</u>	<u>\$ 2,719,471</u>	<u>\$ 9,417,172</u>	<u>\$ 12,334,278</u>

## For the nine months ended September 30, 2018:

	Common Stock		Additional Paid-in Capital	Retained Earnings	Total Stock- holders' Equity
	Shares	Amount			
BALANCE AT DECEMBER 31, 2017	1,983,553	\$ 198,355	\$ 2,709,390	\$ 10,050,186	\$ 12,957,931
Net loss	—	—	—	(10,154)	(10,154)
Stock based compensation	—	—	10,054	—	10,054
BALANCE AT SEPTEMBER 30, 2018	<u>1,983,553</u>	<u>\$ 198,355</u>	<u>\$ 2,719,444</u>	<u>\$ 10,040,032</u>	<u>\$ 12,957,831</u>

**IKONICS CORPORATION**  
**CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)**

	Nine Months Ended September 30,	
	2019	2018
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (733,486)	\$ (10,154)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation	476,906	587,836
Amortization	33,662	27,463
Stock based compensation	6,330	10,054
Net gain on sale and disposal of property and equipment	(8,481)	—
Deferred income taxes	(183,000)	12,839
Loss on intangible asset abandonment	87,122	—
Changes in working capital components:		
Trade receivables	3,775	214,519
Inventories	(526,853)	(184,825)
Prepaid expenses and other assets	(577,492)	(42,328)
Income tax receivable	2,768	(8,092)
Accounts payable	124,992	389,156
Accrued expenses	674,194	74,593
Net cash (used in) provided by operating activities	<u>(619,563)</u>	<u>1,071,061</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(333,535)	(501,295)
Proceeds from sales of property and equipment	15,596	—
Purchases of intangibles assets	(17,528)	(36,289)
Purchases of short-term investments	(4,165,000)	(4,145,000)
Proceeds on sale of short-term investments	4,410,000	4,345,000
Net cash used in investing activities	<u>(90,467)</u>	<u>(337,584)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Payment on long-term debt	(104,772)	(103,452)
Repurchase of common stock	(49,596)	—
Net cash used in financing activities	<u>(154,368)</u>	<u>(103,452)</u>
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(864,398)</b>	<b>630,025</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>1,623,137</b>	<b>929,700</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b><u>\$ 758,739</u></b>	<b><u>\$ 1,559,725</u></b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid for interest	<u>\$ 59,889</u>	<u>\$ 58,084</u>
Cash paid for income taxes, net	<u>\$ 9,457</u>	<u>\$ 7,652</u>

See notes to condensed financial statements.

**IKONICS CORPORATION**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

1. Basis of Presentation

The condensed balance sheet of IKONICS Corporation (the "Company") as of September 30, 2019, and the related condensed statements of operations for the three and nine months ended September 30, 2019 and 2018, the condensed statements of stockholders' equity for the three and nine months ended September 30, 2019 and 2018, and condensed cash flows for the nine months ended September 30, 2019 and 2018, have been prepared without being audited.

In the opinion of management, these statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of IKONICS Corporation as of September 30, 2019, and the results of operations and cash flows for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. Therefore, these statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

The results of operations for interim periods are not necessarily indicative of results that will be realized for the full fiscal year.

The Company has evaluated subsequent events occurring after the date of the financial statements for events requiring recording or disclosure in the financial statements.

2. Short-Term Investments

The Company's \$2.5 million of short-term investments at September 30, 2019 is comprised of 10 fully insured certificates of deposit with original maturities ranging from four to six months and interest rates ranging from 1.85% to 2.40%

3. Inventories

The major components of inventories as of September 30, 2019 and December 31, 2018 were as follows:

	<u>Sep 30, 2019</u>	<u>Dec 31, 2018</u>
Raw materials	\$ 1,747,952	\$ 1,767,458
Work-in-progress	424,893	370,075
Finished goods	1,748,707	1,196,516
Reduction to LIFO cost	<u>(1,348,111)</u>	<u>(1,287,461)</u>
Total Inventories	<u>\$ 2,573,441</u>	<u>\$ 2,046,588</u>

4. Earnings Per Common Share (EPS)

Basic EPS is calculated using net loss divided by the weighted average of common shares outstanding. Diluted EPS is calculated similarly to Basic EPS except that the weighted average number of common shares outstanding is increased to include the number of additional common shares that would have been outstanding if the potential dilutive common shares, such as those shares subject to options, had been issued. The options disclosed in Note 5 have been excluded from the computation because of their antidilutive effect.

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

	<u>Three Months Ended</u>	
	<u>Sep 30, 2019</u>	<u>Sep 30, 2018</u>
Weighted average common shares outstanding	1,978,926	1,983,553
Dilutive effect of stock options	<u>—</u>	<u>—</u>
Weighted average common and common equivalent shares outstanding	<u>1,978,926</u>	<u>1,983,553</u>
	<u>Nine Months Ended</u>	
	<u>Sep 30, 2019</u>	<u>Sep 30, 2018</u>
Weighted average common shares outstanding	1,981,568	1,983,553
Dilutive effect of stock options	<u>—</u>	<u>—</u>
Weighted average common and common equivalent shares outstanding	<u>1,981,568</u>	<u>1,983,553</u>

**IKONICS CORPORATION**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

If the Company was in a net income position for the three months ended September 30, 2019, all 19,250 options outstanding with a weighted average exercise price of \$11.32 would have remained excluded from the computation of weighted average common and common equivalent shares outstanding as the options were anti-dilutive. If the Company was in a net income position for the nine months ended September 30, 2019, 3,250 options outstanding with a weighted exercise price of \$7.15, would have been included in the computation of weighted average common and common equivalent shares outstanding as the options were dilutive while 16,000 options outstanding with a weighted average exercise price of \$12.17 would have remained excluded from the computation of weighted average common and common equivalent shares outstanding as the options were anti-dilutive.

If the Company was in a net income position for the three and nine months ended September 30, 2018, 5,000 options outstanding with a weighted average exercise price of \$8.76 would have been included as part of the weighted average common and common equivalent shares outstanding as the options would have been dilutive while 13,000 options outstanding with a weighted average exercise price of \$14.94 would have remained excluded as the options were anti-dilutive.

5. Stock-Based Compensation

The Company maintains the 2019 Equity Incentive Plan (the "2019 Plan"). The 2019 Plan replaced the 1995 Incentive Stock Option Plan (the "1995 Plan") upon its ratification by shareholders in April 2019. The 1995 plan authorized the issuance of up to 442,750 shares of common stock. Of those shares, 16,000 were subject to outstanding options as of September 30, 2019. Awards granted under the 1995 Plan will remain in effect until they are exercised or expire according to their terms. At the time the 2019 Plan was approved, there were 102,157 shares reserved for future grants under the 1995 Plan which will no longer be available for future grants.

Under the terms of the 2019 Plan, the number of shares of common stock that may be the subject of awards and issued under the 2019 Plan was initially set at 102,157. Subsequent to the approval of the 2019 Plan, 750 outstanding options granted under the 1995 were forfeited. Under the terms of the 2019 Plan, those forfeited options are added back to the 2019 Plan reserve pool bringing the number of shares of common stock available for future awards under the 2019 Plan to 102,907. As of September 30, 2019, 3,250 options have been granted under the 2019 Plan.

The Company charged compensation cost of approximately \$2,500 against the loss for the three months ended September 30, 2019 and approximately \$3,600 for the three months ended September 30, 2018. For the first nine months of 2019, the Company charged compensation cost of approximately \$6,300 and approximately \$10,100 for the same period in 2018. As of September 30, 2019, there was approximately \$14,600 of unrecognized compensation cost related to unvested share-based compensation awards. That cost is expected to be recognized over the next three years.

The Company receives a tax deduction for certain stock option exercises during the period in which the options are exercised, generally for the excess of the market price at the time the stock options are exercised over the exercise price of the options, which increases additional paid in capital and reduces income taxes payable.

No stock options were exercised during the nine months ended September 30, 2019 or September 30, 2018.

There were 3,250 options granted during the nine months ended September 30, 2019. During the nine months ended September 30, 2018, 2,750 options were granted. The fair value of options granted during the nine months ended September 30, 2019 and 2018 was estimated using the Black Scholes option pricing model with the following assumptions:

	2019	2018
Dividend yield	0	0
Expected volatility	37.5%	40.0%
Expected life of option (years)	5	5
Risk-free interest rate	1.7%	2.8%
Fair value of each option on grant date	\$ 2.53	\$ 3.38

Stock option activity during the nine months ended September 30, 2019 was as follows:

	Shares	Weighted Average Exercise Price
Outstanding at January 1, 2019	18,000	\$ 13.22
Granted	3,250	7.15
Exercised	—	—
Expired and forfeited	(2,000)	21.69
Outstanding at September 30, 2019	19,250	\$ 11.32
Exercisable at September 30, 2019	13,415	\$ 12.83

The aggregate intrinsic value of all options outstanding and exercisable at September 30, 2019 was \$0.

**IKONICS CORPORATION**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

6. Segment Information

The Company's reportable segments are strategic business units that offer different products and have varied customer bases. There are four reportable segments: Chromaline, IKONICS Imaging, Digital Texturing (DTX) and Advanced Material Solutions (AMS). Chromaline sells screen printing film, emulsions, and inkjet receptive film primarily to distributors and some end users. IKONICS Imaging sells photo resistant film, art supplies, glass, and related abrasive etching equipment to both end users and distributors. AMS provides sound deadening and weight reduction 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. Prior to 2019, the Company had one additional business segment called Export. Export was primarily responsible for both Chromaline and IKONICS Imaging sales outside of the United States and Canada. Chromaline products sold within the United States and Canada prior to 2019 were included in a segment called Domestic. To better reflect how the Company manages these businesses, beginning in 2019, the Export segment was eliminated. Sales previously recorded in the Export segment are now included in either the Chromaline or IKONICS Imaging segments, respectively. Both the 2019 and 2018 financial information reflect the new reportable segments. The accounting policies applied to determine the segment information are the same as those described in the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

Management evaluates the performance of each segment based on the components of divisional income (loss). Assets and liabilities are not allocated to segments, except for trade receivables which are allocated based on the previous segmentation. Financial information with respect to the reportable segments follows:

**For the three months ended September 30, 2019:**

	IKONICS					
	Chromaline	IKONICS Imaging	DTX	AMS	Unalloc.	Total
Net sales	\$ 2,869,664	\$ 1,117,209	\$ 84,661	\$ 458,827	\$ —	\$ 4,530,361
Cost of goods sold	2,115,702	628,325	31,217	343,055	—	3,118,299
Gross profit	753,962	488,884	53,444	115,772	—	1,412,062
Selling general and administrative*	452,592	248,780	41,866	89,597	514,569	1,347,404
Research and development*	—	—	—	—	218,467	218,467
Income (loss) from operations	<u>\$ 301,370</u>	<u>\$ 240,104</u>	<u>\$ 11,578</u>	<u>\$ 26,175</u>	<u>\$ (733,036)</u>	<u>\$ (153,809)</u>

**For the three months ended September 30, 2018:**

	IKONICS					
	Chromaline	IKONICS Imaging	DTX	AMS	Unalloc.	Total
Net sales	\$ 3,048,495	\$ 975,852	\$ 158,862	\$ 468,149	\$ —	\$ 4,651,358
Cost of goods sold	2,113,448	560,337	30,279	420,475	—	3,124,539
Gross profit	935,047	415,515	128,583	47,674	—	1,526,819
Selling general and administrative*	469,854	260,025	42,922	91,876	504,168	1,368,845
Research and development*	—	—	—	—	179,915	179,915
Income (loss) from operations	<u>\$ 465,193</u>	<u>\$ 155,490</u>	<u>\$ 85,661</u>	<u>\$ (44,202)</u>	<u>\$ (684,083)</u>	<u>\$ (21,941)</u>

**For the nine months ended September 30, 2019:**

	IKONICS					
	Chromaline	IKONICS Imaging	DTX	AMS	Unalloc.	Total
Net sales	\$ 8,006,121	\$ 3,164,143	\$ 290,022	\$ 1,195,177	\$ —	\$ 12,655,463
Cost of goods sold	5,949,536	1,714,835	116,810	1,024,672	—	8,805,853
Gross profit	2,056,585	1,449,308	173,212	170,505	—	3,849,610
Selling general and administrative*	1,364,685	819,284	111,232	266,107	1,506,922	4,068,230
Research and development*	—	—	—	—	667,774	667,774
Income (loss) from operations	<u>\$ 691,900</u>	<u>\$ 630,024</u>	<u>\$ 61,980</u>	<u>\$ (95,602)</u>	<u>\$ (2,174,696)</u>	<u>\$ (886,394)</u>

**For the nine months ended September 30, 2018:**

	IKONICS					
	Chromaline	IKONICS Imaging	DTX	AMS	Unalloc.	Total
Net sales	\$ 8,489,197	\$ 3,164,133	\$ 341,850	\$ 1,361,833	\$ —	\$ 13,357,013
Cost of goods sold	5,816,275	1,693,561	89,283	1,206,341	—	8,805,460
Gross profit	2,672,922	1,470,572	252,567	155,492	—	4,551,553
Selling general and administrative*	1,336,575	789,683	110,370	274,136	1,516,027	4,026,791
Research and development*	—	—	—	—	490,463	490,463
Income (loss) from operations	<u>\$ 1,336,347</u>	<u>\$ 680,889</u>	<u>\$ 142,197</u>	<u>\$ (118,644)</u>	<u>\$ (2,006,490)</u>	<u>\$ 34,299</u>

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

**IKONICS CORPORATION**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

Trade receivables by segment as of September 30, 2019 and December 31, 2018 were as follows:

	<u>Sep 30, 2019</u>	<u>Dec 31, 2018</u>
Chromaline	\$ 1,450,035	\$ 1,550,411
IKONICS Imaging	461,897	360,551
DTX	50,100	15,692
AMS	302,080	331,708
Unallocated	<u>(52,672)</u>	<u>(43,147)</u>
<b>Total</b>	<u>\$ 2,211,440</u>	<u>\$ 2,215,215</u>

7. Income Taxes

The Company records its interim provision for income taxes by applying its estimated annual effective tax rate to the year-to-date pre-tax (loss) income and adjusting for discrete tax items recorded in the period. Deferred income taxes result from temporary differences between the reporting of amounts for financial statement purposes and income tax purposes. These differences relate primarily to different methods used for income tax reporting purposes, including for depreciation and amortization, warranty and vacation accruals, and deductions related to allowances for doubtful accounts receivable and inventory reserves. The provision for income taxes included current federal and state income tax expense, as well as deferred federal and state income tax expense.

The effective tax rate for the three months ended September 30, 2019 was an expense of 1.5%, compared to a benefit of 21.4% for the three months ended September 30, 2018. The primary driver of the change in the Company's effective tax rate is attributable to an increase in the tax expense relating to the derecognition of the Company's net deferred tax asset of \$34,000. The Company recorded an income tax expense of \$2,000 and a benefit of \$7,000 for the three months ended September 30, 2019 and 2018, respectively.

The effective tax rate for the nine months ended September 30, 2019 is a benefit of 18.9%, compared to an expense of 552.3% for the nine months ended September 30, 2018. The primary driver of the decrease in the effective tax rate was a result of a year-to-date loss for the current period as compared to income for the same period in 2018. The Company recorded an income tax benefit of \$171,000 and an income tax expense of \$12,000 for the nine months ended September 30, 2019 and 2018, respectively.

The Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority is more-likely-than-not to sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the condensed financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant tax authority. As of September 30, 2019 the Company has no unrecognized tax benefits.

Management assesses the available positive and negative evidence to estimate whether sufficient future taxable income will be generated to permit use of the existing deferred tax assets. A significant piece of objective negative evidence evaluated was the cumulative loss incurred over the three-year period ended September 30, 2019. Such objective evidence limits the ability to consider other subjective evidence, such as our projections for future growth.

On the basis of this evaluation, as of September 30, 2019, an incremental valuation allowance of \$34,000 has been recorded to recognize only the portion of the deferred tax asset that is more likely than not to be realized. The amount of the deferred tax asset considered realizable, however, could be adjusted if estimates of future taxable income during the carryforward period are reduced or increased or if objective negative evidence in the form of cumulative losses is no longer present and additional weight is given to subjective evidence such as our projections for growth.

The Company is not currently under examination in any jurisdiction. In the event of any future tax assessments, the Company has elected to record the income taxes and any related interest and penalties as income tax expense on its statement of operations.

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 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. As of September 30, 2019 the Company was not in compliance with the debt service coverage ratio covenant, but has obtained a waiver for the non-compliance. There is no certainty that a waiver can be obtained in the future if similar violations occur. If the Company has future violations of its covenants, and is unable to obtain appropriate waivers, it could have a significant adverse effect on the Company's liquidity. The Company believes that any adverse effect of such a possible outcome is mitigated by its strong working capital including cash, cash equivalents, and short-term investments of \$3.2 million along with the Company's \$2.0 million available line of credit as of September 30, 2019.

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 August 30, 2021 that bears interest at 1.8 percentage points over the 30-day LIBOR rate. The Company did not utilize this line of credit during the first nine months of 2019 or 2018 and there were no borrowings outstanding as of September 30, 2019 or December 31, 2018. 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.

IKONICS CORPORATION

*The information presented below in Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended. Statements that are not historical or current facts, including statements about beliefs and expectations, are forward-looking statements. These forward-looking statements include statements relating to our future plans and objectives and results. Such statements are subject to risks and uncertainties, including those discussed elsewhere in this report and under the heading "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2018, as updated in our subsequent reports filed with the SEC, which could cause actual results to differ materially from those projected. Because actual results may differ, readers are cautioned not to place undue reliance on these forward-looking statements.*

**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following management's discussion and analysis focuses on those factors that had a material effect on the Company's financial results of operations during the third quarter of 2019 and first nine months of 2019, as well as the same periods of 2018. It should be read in connection with the Company's condensed unaudited financial statements and notes thereto included in this Form 10-Q.

**Critical Accounting 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 estimates, which IKONICS believes are the most critical to aid in fully understanding and evaluating its reported financial results, include the following:

*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 in accordance with FASB ASC 830, *Foreign Currency Matters*. The Company also maintains a provision for any customer related returns based upon historical experience of actual returns and any specifically identified product issues, refunds or credits.

*Inventories.* Inventories are valued at the lower of cost or net realizable 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 bases. 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. Deferred tax assets and liabilities are presented as long-term on a net basis. 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.

*Revenue recognition.* Revenue is measured based on consideration specified in the contract with a customer, adjusted for any applicable estimates of variable consideration and other factors affecting the transaction price, including noncash consideration, consideration paid or payable to customers and significant financing components. 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 arrangements with certain customers. Revenue from all customers is recognized when a performance obligation is satisfied by transferring control of a distinct good or service to a customer.

Individually promised goods and services in a contract are considered a distinct performance obligation and accounted for separately if the customer can benefit from the individual good or service on its own or with other resources that are readily available to the customer and the good or service is separately identifiable from other promises in the arrangement. When an arrangement includes multiple performance obligations, the consideration is allocated between the performance obligations in proportion to their estimated standalone selling price. Costs related to products delivered are recognized in the period incurred, unless criteria for capitalization of costs are met. Costs of revenues consist primarily of direct labor, manufacturing overhead, materials and components. The Company does not incur significant upfront costs to obtain a contract. If costs to obtain a contract were to become material, the costs would be recorded as an asset and amortized to expense in a manner consistent with the related recognition of revenue.

The Company excludes governmental assessed and imposed taxes on revenue transactions that are invoiced to customers from revenue. The Company includes freight billed to customers in revenue. Shipping and handling costs associated with outbound freight after control over a product has transferred to a customer are accounted for as a fulfillment cost and are included in cost of goods sold.

The timing of revenue recognition, billings and cash collections results in accounts receivable on the balance sheet.

*Performance obligations.* A performance obligation is a promise in a contract to transfer a distinct good or service to the customer. A contract's transaction price is allocated to each distinct performance obligation in proportion to its standalone selling price and recognized as revenue when, or as, the performance obligation is satisfied. The Company's various performance obligations and the timing or method of revenue recognition are discussed below:

The Company sells its products to both distributors and end-users. Each unit of product delivered under a customer order represents a distinct and separate performance obligation as the customer can benefit from each unit on its own or with other resources that are readily available to the customer and each unit of product is separately identifiable from other products in the arrangement.

The transaction price for the Company's products is the invoiced amount. The Company does not have variable consideration in the form of refunds, credits, rebates, price concessions, pricing incentives or other items impacting transaction price. The purchase order pricing in arrangements with customers is deemed to approximate standalone selling price; therefore, the Company does not need to allocate proceeds on a relative standalone selling price allocation between performance obligations. The Company applies the practical expedient in FASB ASC 606-10-50-14 and does not disclose information about remaining performance obligations that have original expected durations of one year or less. There are no material obligations that extend beyond one year.

Revenue is recognized when transfer of control occurs as defined by the terms in the customer agreement. The Company immediately recognizes incidental items that are immaterial in the context of the contract. The Company has also applied the practical expedient in FASB ASC 606-10-32-18 regarding the adjustment of the promised amount of consideration for the effects of a significant financing component when the customer pays for that good or service within one year or less, as the Company does not have any significant financing components in its customer arrangements as payment is received at or shortly after the point of sale, generally thirty to ninety days.

The Company estimates returns based on an analysis of historical experience if the right to return products is granted to its customers. The Company does not record a return asset as non-conforming products are generally not returned. The Company's return policy does not vary by geography. The customer has no rotation or price protection rights. The Company is not under a warranty obligation except as described below.

*Trade receivables.* Trade receivables include amounts invoiced and currently due from customers. The amounts due are stated at their net estimated realizable value. The Company records an allowance for doubtful accounts to provide for the estimated amount of receivables that will not be collected. The allowance is 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 considers 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.

*Sales commissions.* Sales commissions paid to sales representatives are eligible for capitalization as they are incremental costs that would not have been incurred without entering into a specific sales arrangement and are recoverable through the expected margin on the transaction. The Company has elected to apply the practical expedient provided by FASB ASC 340-40-25-4 and recognize the incremental costs of obtaining contracts as an expense when incurred, as the amortization period of the assets that would have otherwise been recognized is one year or less. The Company records these costs in selling, general, and administrative expense.

*Product warranty.* The Company offers warranties on various products and services. These warranties are assurance type warranties that are not sold on a standalone basis; therefore, they are not considered distinct performance obligations. The Company estimates the costs that may be incurred under its warranties and records a liability in the amount of such costs at the time the revenue is recognized for the product sale.

*International revenue.* The Company markets its products to numerous countries in North America, Europe, Latin America, Asia and other parts of the world. Foreign sales were approximately 29% of total sales during the first nine months of 2019 and 2018.

## **Results of Operations**

### ***Quarter Ended September 30, 2019 Compared to Quarter Ended September 30, 2018***

*Sales.* The Company's 2019 third quarter sales of \$4.5 million were \$121,000, or 2.6%, lower than the 2018 third quarter sales of \$4.7 million. Chromaline third quarter 2019 sales of \$2.9 million decreased by 5.9% from third quarter 2018 sales of \$3.0 million. Most of the Chromaline sales decrease is related to lower domestic sales in addition to lower sales in China as tariffs continue to be a drag on the Chinese markets. DTX 2019 third quarter sales decreased by \$74,000, or 46.7%, compared to the same period last year. DTX third quarter 2018 sales benefitted from an \$86,000 film order which occurs approximately every other year. AMS sales for the third quarter of 2019 were down \$9,000, or 2.0%, versus the same period in 2018. Partially offsetting these sales decreases, IKONICS Imaging 2019 third quarter sales of \$1.1 million were \$141,000, or 14.5%, higher than the 2018 third quarter sales. IKONICS Imaging sales during the current year third quarter were favorably impacted by increased film and equipment sales and sales from the Company's recently introduced IKONART™ product.

**Gross Profit.** Gross profit was \$1.4 million, or 31.2% of sales, in the third quarter of 2019 compared to \$1.5 million, or 32.8% of sales, for the same period in 2018. The Chromaline gross margin decrease from 30.7% in the third quarter of 2018 to 26.3% for the third quarter of 2019 was due to lower sales volumes and a less favorable sales mix as an increase in lower margin sales into Asia were offset by a decrease in higher margin domestic sales. An increase in certain raw material pricing along with Chinese tariffs has also unfavorably impacted the gross margin for Chromaline products. The DTX gross margin for the third quarter of 2019 was also lower at 63.1% compared to 80.9% for the same period in 2018 due to a decrease in higher margin film sales. Despite lower sales volumes, the AMS gross margin improved to 25.2% in the third quarter of 2019, up from 10.2% in the third quarter of 2018 as a result of lower costs in 2019. Increased sales volume improved the IKONICS Imaging gross margin from 42.6% in the third quarter of 2018 to 43.8% in the third quarter of 2019.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses were \$1.3 million, or 29.7% of sales, in the third quarter of 2019 compared to \$1.4 million, or 29.4% of sales, for the same period in 2018. Selling, general and administrative expenses for the third quarter of 2019 decreased primarily due to lower medical insurance and promotional expenses.

**Research and Development Expenses.** Research and development expenses during the third quarter of 2019 were \$218,000, or 4.8% of sales, versus \$180,000, or 3.9%, of sales for the same period in 2018. The 2019 third quarter increase is related to additional research and development staffing expenses. Additionally, legal and patent expenses in the third quarter of 2019 increased due to the write off of patent application costs of \$16,000 that were previously recorded as an asset, as the Company determined that it would no longer continue to pursue those patent applications.

**Interest Expense.** Interest expense for the third quarter of 2019 and 2018 was \$23,000.

**Income Taxes.** For the third quarter of 2019, the Company realized income tax expense of \$2,000, or an effective tax rate of 1.5%, compared to a benefit of \$7,000, or an effective tax rate of 21.4% for the three months ended September 30, 2018. The primary driver of the change in the Company's effective tax rate is a valuation allowance recorded against deferred tax assets generated during the third quarter of 2019. The income tax provision for 2018 differs from the expected tax benefit due to unfavorable non-deductible items and generation of research and development tax credits.

### **Nine Months Ended September 30, 2019 Compared to Nine Months Ended September 30, 2018**

**Sales.** The Company's 2019 September year-to-date sales of \$12.7 million were 5.3% lower than the same period sales in 2018 of \$13.4 million. Chromaline sales for the first nine months of 2019 decreased by \$483,000, or 5.7%, compared to the first nine months of 2018. Chromaline 2019 September year-to-date sales were adversely affected by cold weather shipping constraints in the first quarter since its emulsion products are not freeze-thaw stable. Additionally, Chromaline domestic sales continue to lag behind last year and sales into China have been negatively impacted by tariffs. AMS sales for the first nine months of 2019 decreased from \$1.4 million during the same period in 2018 to \$1.2 million, a 12.2% decrease, resulting from lower sales to its two largest customers. DTX sales for the first nine months of 2019 decreased by \$52,000, or 15.2%, compared to the same period last year. DTX sales in 2018 benefitted from an \$86,000 film order which occurs approximately every other year. IKONICS Imaging sales of \$3.2 million for first nine months of 2019 were flat with 2018 September year-to-date sales.

**Gross Profit.** Gross profit was \$3.8 million, or 30.4% of sales, in the first nine months of 2019 compared to \$4.6 million, or 34.1% of sales, for the same period in 2018. The Chromaline 2019 September year-to-date gross margin decreased to 25.7% from 31.5% in the first nine months of 2018 due to lower sales volumes and a less favorable sales mix as an increase in lower margin sales into Asia were offset by a decrease in higher margin domestic sales. Chinese tariffs have also unfavorably impacted Chromaline's 2019 gross margins. An increase in certain raw material pricing has also unfavorably impacted the gross margin for some Chromaline emulsion products. The DTX gross margin for the first nine months of 2019 was also lower at 59.7% compared to 73.9% for the same period in 2018 due to a decrease in higher margin film sales. Despite lower sales volumes, cost reductions resulted in the AMS gross margin increasing from 11.4% during the first nine months of 2018 to 14.3% for the same period in 2019 while the IKONICS Imaging gross margin for the first nine months of the year was similar in 2019 and 2018.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses were \$4.1 million, or 32.1% of sales, in the first nine months of 2019 compared to \$4.0 million, or 30.1% of sales, for the same period in 2018. Selling, general and administrative expenses for the first nine months of 2019 increased primarily due to higher consulting and health insurance expenses.

**Research and Development Expenses.** Research and development expenses during the first nine months of 2019 were \$668,000, or 5.3% of sales, versus \$490,000, or 3.7%, of sales for the same period in 2018. The increase for the first nine months of 2019 is related to additional research and development staffing expenses. Additionally, legal and patent expenses in the first nine months of 2019 increased due to the write off of \$87,000 in patent application costs that were previously recorded as an asset as the Company determined that it would no longer continue to pursue those patent applications.

**Interest Expense.** Interest expense for the first nine months of 2019 was \$68,000 compared to interest expense of \$67,000 during the first nine months of 2018.

**Income Taxes.** For the first nine months of 2019, the Company realized an income tax benefit of \$171,000, or an effective rate of 18.9%, compared to expense of \$12,000, or an effective tax of 552.3% for the nine months ended September 30, 2018. The primary driver of the change in the effective tax rate is a valuation allowance recorded against net deferred tax assets generated during the first nine months of 2019. The income tax provision for 2018 differs from the expected tax benefit due to unfavorable non-deductible items and generation of research and development tax credits.

### **Liquidity and Capital Resources**

Outside of the building expansion, for which \$3.4 million in financing was obtained during 2016, 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. The Company was not in compliance with its loan covenants as of September 30, 2019, but obtained a waiver for the covenant violation. There is no certainty that a waiver can be obtained if the Company is non-compliant with the covenant in the future. In the future if the Company is non-compliant its covenants, and is unable to obtain appropriate waivers, it could have a significant adverse effect on the Company's liquidity. The Company believes that any adverse effect of such a possible outcome is mitigated by its strong working capital including cash, cash equivalents, and short-term investments of \$3.2 million along with the Company's \$2.0 million available line of credit as of September 30, 2019.

Cash and cash equivalents were \$759,000 and \$1.6 million at September 30, 2019 and December 31, 2018, respectively. Operating activities used \$620,000 in cash during the first nine months of 2019 compared to providing \$1.1 million of cash during the same period in 2018. Cash provided by (used in) operating activities is primarily the result of net losses adjusted for non-cash depreciation, amortization, and certain changes in working capital components discussed in the following paragraph.

During the first nine months of 2019, trade receivables decreased \$4,000. The Company believes that the quality of its receivables is high and that strong internal controls are in place to maintain proper collections. Inventories increased by \$527,000 due to higher finished goods levels as the Company is ramping up inventory levels to meet demand for the remainder of 2019 in addition to lower than expected sales for the first nine months of 2019. Prepaid expenses and other assets increased by \$577,000. The increase is due to a \$694,000 receivable related to the reimbursement of medical insurance costs that the Company will receive from its stop-loss insurance carrier. Accrued expenses increased \$674,000, reflecting an increase in the accrual for health insurance costs. Accounts payable increased by \$125,000 due to the timing of vendor payments. Income taxes receivable decreased by \$3,000.

During the first nine months of 2018, the timing of collections resulted in a \$215,000 decrease in trade receivables. The Company believes that the quality of its receivables is high and that strong internal controls are in place to maintain proper collections. Inventories increased by \$185,000 due to higher raw material and finished goods levels as the Company is increasing inventory levels to meet expected fourth quarter sales demand. Prepaid expenses and other assets increased by \$42,000, reflecting prepayments on annual software license agreements. Accounts payable increased by \$389,000 due to the timing of vendor payments for recent large raw materials purchases. Accrued expenses increased by \$75,000, reflecting an increase in the accrual for health insurance costs while income taxes receivable increased by \$8,000 due to the timing of estimated tax payments compared to the calculated 2018 tax liability.

During the first nine months of 2019, cash used in investing activities was \$90,000. Eighteen certificates of deposits totaling \$4.4 million matured during the first nine months of 2019. The Company purchased seventeen certificates of deposits totaling \$4.2 million. The Company's purchases of property and equipment of \$334,000 were mainly for improvements to production and process capabilities and to replace two vehicles. The Company received \$16,000 in proceeds from the sale of two vehicles and equipment. Also, during the first nine months of 2019, the Company incurred \$18,000 in patent application costs that the Company records as an asset and amortizes upon successful completion of the application process.

During the first nine months of 2018, cash used in investing activities was \$338,000. Eighteen certificates of deposits totaling \$4.3 million matured during the first nine months of 2018. The Company purchased seventeen certificates of deposits totaling \$4.1 million. The Company's purchases of property and equipment of \$501,000 were mainly for building upgrades and improvements to production and process capabilities. Also, during the first nine months of 2018, the Company incurred \$36,000 in patent application costs that the Company records as an asset and amortizes upon successful completion of the application process.

Cash used in investing activities during the first nine months of 2019 and 2018 was \$154,000 and \$103,000, respectively. Related to the Company's loan, the Company made principal payments of \$105,000 during the first nine months of 2019 and \$103,000 during the first nine months of 2018. During the first nine months of 2019, Company repurchased 7,199 shares of its own stock for \$50,000.

A bank line of credit providing for borrowings of up to \$2,050,000 expired on June 30, 2019. The line of credit was renewed and will expire on August 30, 2021. 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 the first nine months of 2019 or 2018, and there were no borrowings outstanding as of September 30, 2019 or December 31, 2018. 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 which it expects to renew once the existing line of credit expires.

The Company was out of compliance with its loan covenants as of September 30, 2019, but obtained a waiver for the covenant violation. There is no certainty that a waiver can be obtained in the future if similar violations occur. If the Company has future violations of its covenants, and is unable to obtain appropriate waivers, it could have a significant adverse effect on the Company's liquidity. The Company feels that any adverse effect of such a possible outcome is mitigated by its strong working capital including cash, cash equivalents, and short-term investments of \$3.2 million along with the Company's \$2.0 million available line of credit as of September 30, 2019.

## **Capital Expenditures**

Through the first nine months of 2019, the Company incurred \$334,000 of capital expenditures mainly for improvements to production and process capabilities and to replace two vehicles.

The Company expects additional capital expenditures in 2019 of approximately \$240,000 including improvements to the Company's coating capabilities, process improvements and information technology upgrades. Currently, the Company expects to fund its capital expenditures with existing cash and cash generated from operating activities.

## **International Activity**

The Company markets its products to numerous countries in North America, Europe, Latin America, Asia and other parts of the world. Foreign sales were approximately 29% of total sales during the first nine months of 2019 and 2018. The fluctuations of certain foreign currencies have not significantly impacted the Company's operations, as the Company's foreign sales are not concentrated in any one region of the world, although a strong U.S. dollar does make the Company's products less competitive internationally. The Company believes its vulnerability due to uncertainties in foreign currency fluctuations and general economic conditions in foreign countries is not significant.

The Company's foreign transactions are primarily negotiated, invoiced and paid in U.S. dollars, while a portion is transacted in Euros. The Company has not implemented an economic hedging strategy to reduce the risk of foreign currency translation or transaction exposures, as management does not believe this to be a significant risk based on the scope and geographic diversity of the Company's foreign operations as of September 30, 2019. Furthermore, the impact of foreign exchange on the Company's balance sheet and operating results was not material in either 2019 or 2018.

## **Future Outlook**

IKONICS has spent an average of approximately 5.0% 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.

Despite lower sales for the first nine months of 2019, the Company continues to make progress on its AMS business. The Company has three long-term sales agreements in place for its technology with major aerospace companies.

The Company is also continuing to pursue DTX-related business initiatives. 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 as part of its joint development agreement with AKK, a German manufacturer of high quality printers, 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 Chromaline 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 the Company believes will contribute to growth. In October 2017, the Company introduced SubTHAT!™, a patent-pending product for the dye-sublimation market. Early in 2019 the Company introduced its new IKONART™ product to positive reviews and is generating sales. IKONART™ provides a new way to make custom reusable stencils for the creative arts markets. 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 international growth challenging.

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

### **Recent Accounting Pronouncements**

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 adopted ASU No. 2016-02 as of January 1, 2019. The adoption of this standard did not have a material impact on its financial statements.

### **Off Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements.

### **ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

Not applicable

### **ITEM 4. Controls and Procedures**

As of the end of the period covered by this report, the Company conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of the Company's disclosure control and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based on this evaluation, the principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There were no changes to the Company's internal control over financial reporting that occurred during the first nine months of 2019 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION**ITEM 1. Legal Proceedings**

None

**ITEM 1A. Risk Factors**

Not applicable

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**The Company repurchased shares as indicated in the table below during the third quarter of 2019<sup>(1)</sup>:

	(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
July 1, 2019 through July 31, 2019.....	—	\$ —	—	—
August 1, 2019 through May 31, 2019.....	3,682	\$ 6.39	3,682	93,576
September 1, 2019 through September 30, 2019.....	775	\$ 6.60	775	92,801
Total	<u>4,457</u>		<u>4,457</u>	

(1) In 2017, the Company's board of directors had authorized the repurchase of 100,000 shares of common stock. A total of 33,500 shares have been repurchased under this program in prior years. On April 29, 2019 the Company's board of directors approved an additional repurchase authorization of 33,500 shares of the Company's common stock bringing the total repurchase authorization to 100,000 shares of common. A total of 40,699 shares have been repurchased under this program including the 4,457 share repurchased during the third quarter of 2019. The plan allows for an additional 92,801 share to be repurchased. The share repurchase authorizations do not have an expiration date.

**ITEM 3. Defaults upon Senior Securities**

Not applicable

**ITEM 4. Mine Safety Disclosures**

Not applicable

**ITEM 5. Other Information**

None

**ITEM 6. Exhibits**

The following exhibits are filed as part of this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2019:

<u>Exhibit</u>	<u>Description</u>
3.1	<a href="#">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 (File No. 000-25727).)</a>
3.2	<a href="#">Amended and Restated By-Laws of the Company, as amended. (Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on April 30, 2018 (File No. 000-25757).)</a>
31.1	<a href="#">Rule 13a-14(a)/15d-14(a) Certifications of CEO</a>
31.2	<a href="#">Rule 13a-14(a)/15d-14(a) Certifications of CFO</a>
32	<a href="#">Section 1350 Certifications</a>
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T

IKONICS CORPORATION

**SIGNATURES**

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

IKONICS CORPORATION

DATE: November 13, 2019

By: /s/ Jon Gerlach  
Jon Gerlach,  
Chief Financial Officer, and  
Vice President of Finance

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

I, William C. Ulland, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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-15f 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; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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.
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: November 13, 2019

/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 quarterly report on Form 10-Q 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-15f 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; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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.
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: November 13, 2019

/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: November 13, 2019

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

Date: November 13, 2019

/s/ Jon Gerlach  
Jon Gerlach  
Chief Financial Officer and Vice President of Finance