IKONICS CORP
Form 10-Q
August 13, 2015
Table of Contents

# U.S. SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the Quarterly Period Ended June 30, 2015**

**or**

**o 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** | **41-0730027** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. employer identification no.) |
| **4832 Grand Avenue**<br>**Duluth, Minnesota** | **55807** |
| (Address of principal executive offices) | (Zip code) |

**(218) 628-2217**

Issuer s telephone number

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act 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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.)

Yes x No o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

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

| | |
|---|---|
| Large accelerated filer o | Accelerated filer o |
| Non-accelerated filer (Do not check if a smaller reporting company) o | Smaller reporting company x |

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 - 2,018,253 shares outstanding as of August 7, 2015.

Table of Contents

**IKONICS Corporation**

QUARTERLY REPORT ON FORM 10-Q


| | | | PAGE NO. |
|---|---|---|---|
| PART I. | FINANCIAL INFORMATION | | |
| Item 1. | | Financial Statements: | |
| | | Condensed Balance Sheets as of June 30, 2015 (unaudited) and December 31, 2014 | 3 |
| | | Condensed Statements of Operations for the Three Months and Six Months Ended June 30, 2015 and 2014 (unaudited) | 4 |
| | | Condensed Statements of Cash Flows for the Six Months Ended June 30, 2015 and 2014 (unaudited) | 5 |
| | | Notes to Condensed Financial Statements (unaudited) | 6 |
| Item 2. | | Management s Discussion and Analysis of Financial Condition and Results of Operations | 12 |
| Item 3. | | Quantitative and Qualitative Disclosures about Market Risk | 18 |
| Item 4. | | Controls and Procedures | 18 |
| PART II. | OTHER INFORMATION | | 19 |
| | SIGNATURES | | 20 |

Table of Contents

PART I FINANCIAL INFORMATION

**ITEM 1. Condensed Financial Statements**

**IKONICS CORPORATION**

**CONDENSED BALANCE SHEETS**

| | June 30 2015 (unaudited) | December 31 2014 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 2,368,778 | $ 1,936,214 |
| Short-term investments | 1,205,000 | 1,766,000 |
| Trade receivables, less allowance of $56,000 in 2015 and $49,000 in 2014 | 2,154,908 | 2,096,328 |
| Inventories | 2,363,893 | 2,630,650 |
| Prepaid expenses and other assets | 145,920 | 86,400 |
| Income taxes receivable | 246,111 | 163,651 |
| Deferred income taxes | 178,000 | 178,000 |
| Total current assets | 8,662,610 | 8,857,243 |
| PROPERTY, PLANT, AND EQUIPMENT, at cost: | | |
| Land and building | 6,500,802 | 6,247,781 |
| Machinery and equipment | 4,208,267 | 3,956,561 |
| Office equipment | 817,072 | 754,220 |
| Vehicles | 247,356 | 247,356 |
| | 11,773,497 | 11,205,918 |
| Less accumulated depreciation | 6,116,830 | 5,789,070 |
| | 5,656,667 | 5,416,848 |
| INTANGIBLE ASSETS, less accumulated amortization of $212,079 in 2015 and $198,918 in 2014 | 325,113 | 353,871 |
| | $ 14,644,390 | $ 14,627,962 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ 596,217 | $ 371,181 |
| Accrued compensation | 248,483 | 294,706 |
| Other accrued liabilities | 107,015 | 78,610 |
| Total current liabilities | 951,715 | 744,497 |
| DEFERRED INCOME TAXES | 545,000 | 545,000 |
| Total liabilities | 1,496,715 | 1,289,497 |

| | | | | |
|---|---|---|---|---|
| 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 2,018,253 shares in 2015 and 2014 | | 201,825 | | 201,825 |
| Additional paid-in capital | | 2,691,740 | | 2,681,307 |
| Retained earnings | | 10,254,110 | | 10,455,333 |
| Total stockholders equity | | 13,147,675 | | 13,338,465 |
| | $ | 14,644,390 | $ | 14,627,962 |

See notes to condensed financial statements

Table of Contents

**IKONICS CORPORATION**

**CONDENSED STATEMENTS OF OPERATIONS (Unaudited)**

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| NET SALES | $ 4,653,548 | $ 4,924,747 | $ 8,251,437 | $ 9,389,323 |
| COST OF GOODS SOLD | 3,013,806 | 3,213,875 | 5,511,020 | 5,919,298 |
| GROSS PROFIT | 1,639,742 | 1,710,872 | 2,740,417 | 3,470,025 |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES | 1,252,521 | 1,240,413 | 2,668,118 | 2,541,063 |
| RESEARCH AND DEVELOPMENT EXPENSES | 192,539 | 177,479 | 348,383 | 320,809 |
| INCOME (LOSS) FROM OPERATIONS | 194,682 | 292,980 | (276,084) | 608,153 |
| OTHER | 1,510 | 1,552 | 3,206 | 3,510 |
| INCOME (LOSS) BEFORE INCOME TAXES | 196,192 | 294,532 | (272,878) | 611,663 |
| INCOME TAX EXPENSE (BENEFIT) | 168,468 | 96,100 | (71,655) | 208,316 |
| NET INCOME (LOSS) | $ 27,724 | $ 198,432 | $ (201,223) | $ 403,347 |
| EARNINGS (LOSS) PER COMMON SHARE: | | | | |
| Basic | $ 0.01 | $ 0.10 | $ (0.10) | $ 0.20 |
| Diluted | $ 0.01 | $ 0.10 | $ (0.10) | $ 0.20 |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING: | | | | |
| Basic | 2,018,253 | 2,016,885 | 2,018,253 | 2,014,836 |
| Diluted | 2,018,792 | 2,019,721 | 2,018,253 | 2,016,774 |

See notes to condensed financial statements.

Table of Contents

**IKONICS CORPORATION**

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

| | Six Months Ended June 30 | |
|---|---|---|
| | **2015** | **2014** |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | $ (201,223) | $ 403,347 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation | 327,759 | 320,140 |
| Amortization | 13,161 | 12,887 |
| Stock based compensation | 10,433 | 11,502 |
| Loss on disposal of property, plant and equipment | | 3,102 |
| Loss on intangible asset abandonment | 45,873 | |
| Changes in working capital components: | | |
| Trade receivables | (58,580) | (193,186) |
| Inventories | 266,757 | (76,405) |
| Prepaid expenses and other assets | (59,520) | (31,713) |
| Income taxes receivable | (82,460) | (33,307) |
| Accounts payable | 225,036 | (20,571) |
| Accrued expenses | (17,818) | (31,419) |
| Net cash provided by operating activities | 469,418 | 364,377 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property, plant and equipment | (567,578) | (403,212) |
| Proceeds from sales of equipment and vehicles | | 9,163 |
| Purchases of intangibles | (30,276) | (38,590) |
| Purchases of short-term investments | (650,000) | (1,510,000) |
| Proceeds on sale of short-term investments | 1,211,000 | 958,948 |
| Net cash used in investing activities | (36,854) | (983,691) |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from exercise of stock options | | 44,730 |
| | | |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 432,564 | (574,584) |
| | | |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 1,936,214 | 1,704,300 |
| | | |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 2,368,778 | $ 1,129,716 |
| | | |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | |
| Cash paid for income taxes. | $ 10,805 | $ 241,624 |

See notes to condensed financial statements.

Table of Contents

**IKONICS CORPORATION**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

## 1. Basis of Presentation

The condensed balance sheet of IKONICS Corporation (the Company ) as of June 30, 2015, and the related condensed statements of operations for the three and six months ended June 30, 2015 and 2014, and cash flows for the six months ended June 30, 2015 and 2014, 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 June 30, 2015, 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, 2014.

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

## 2. Short-Term Investments

The Company s $1,205,000 of short-term investments at June 30, 2015 is comprised of fully insured certificates of deposit with original maturities ranging from six to twelve months and interest rates ranging from 0.3% to 0.5%.

## 3. Inventories

The major components of inventories are as follows:

| | June 30, 2015 | Dec 31, 2014 |
|---|---|---|
| Raw materials | $ 1,854,302 | $ 2,020,151 |
| Work-in-progress | 421,764 | 407,964 |
| Finished goods | 1,399,940 | 1,517,151 |
| Reduction to LIFO cost | (1,312,113) | (1,314,616) |
| | | |
| Total Inventory | $ 2,363,893 | $ 2,630,650 |

Table of Contents

**IKONICS CORPORATION**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

## 4. Earnings Per Common Share (EPS)

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

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

| | Three Months Ended | |
|---|---|---|
| | **June 30, 2015** | **June 30, 2014** |
| Weighted average common shares outstanding | 2,018,253 | 2,016,885 |
| Dilutive effect of stock options | 539 | 2,836 |
| Weighted average common and common equivalent shares outstanding | 2,018,792 | 2,019,721 |

| | Six Months Ended | |
|---|---|---|
| | **June 30, 2015** | **June 30, 2014** |
| Weighted average common shares outstanding | 2,018,253 | 2,014,836 |
| Dilutive effect of stock options | | 1,938 |
| Weighted average common and common equivalent shares outstanding | 2,018,253 | 2,016,774 |

For three months ended June 30, 2015, options to purchase 6,250 shares of common stock with a weighted average price of $18.28 were outstanding but were excluded from the computation of common share equivalents because they were anti-dilutive. Options to purchase 1,250 shares of common stock with a weighted average price of $28.25 were outstanding during the three and six months ended June 30, 2014, but were excluded from the computation of common share equivalents because they were anti-dilutive.

If the Company was in a net income position for the first six months of 2015, 5,918 options with a weighted average exercise price of $12.49 would have been included as part of the weighted average common and common equivalent shares outstanding as the options would have been dilutive while 6,250 options with a weighted average exercise price of $18.28 would have remained excluded as the options were anti-dilutive.

## 5. Stock-Based Compensation

The Company maintains a stock incentive plan which authorizes the issuance of up to 442,750 shares of common stock. Of those shares, 12,168 were subject to outstanding options and 108,739 were reserved for future grants at June 30, 2015. 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 the date of grant. Options granted expire up to seven years after the date of grant. Such options generally become exercisable over a one to three year period.

The Company charged compensation cost of approximately $5,700 against income for the three months ended June 30, 2015 and approximately $8,900 for the three months ended June 30, 2014. For the first six months of 2015, the Company charged compensation cost of approximately $10,400 against income and approximately $11,500 for the same period in 2014. As of June 30, 2015, there was approximately $51,000 of unrecognized compensation cost related to unvested share-based compensation awards granted. That cost is expected to be recognized over the next three years.

Table of Contents

**IKONICS CORPORATION**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

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.

Proceeds from the exercise of 5,916 stock options were approximately $45,000 for the six months ended June 30, 2014. No stock options were exercised during the six months ended June 30, 2015.

The fair value of options granted during the six months ended June 30, 2015 and 2014 was estimated using the Black-Scholes option pricing model with the following assumptions:

| | 2015 | 2014 |
|---|---|---|
| Dividend yield | 0% | 0% |
| Expected volatility | 42.3% - 42.4% | 44.3% |
| Expected life of option | Five Years | Five Years |
| Risk-free interest rate | 1.4% -1.5% | 1.7% |
| Fair value of each option on grant date | $5.43 - $6.14 | $11.49 |

There were 7,250 and 1,250 options granted during each of the six months ended June 30, 2015 and 2014, respectively.

Stock option activity during the six months ended June 30, 2015 was as follows:

| | Shares | Weighted Average Exercise Price |
|---|---|---|
| Outstanding at January 1, 2015 | 4,918 | $ 15.78 |
| Granted | 7,250 | 15.25 |
| Exercised | | |
| Expired and forfeited | | |

| | | | |
|---|---|---|---|
| Outstanding at June 30, 2015 | 12,168 | $ | 15.47 |
| Exercisable at June 30, 2015 | 2,833 | $ | 13.53 |

The aggregate intrinsic value of all options outstanding and for those exercisable at June 30, 2015 was approximately $18,000 and $11,000, respectively.

## 6. Commitments

*Building:*

In July 2015, the Company committed to proceed with a 27,300 square-foot building expansion project. The new, 27,300 square-foot structure will contain a 20,500 square-foot production floor in addition to offices and ancillary facilities and is expected to cost $3.5 million. The building will be an addition to IKONICS 37,000 square-foot building on its Morgan Park site in western Duluth, which currently houses AMS production, warehousing, shipping and film conversion for all IKONICS business units. All AMS activities will relocate to the new facility with an expected project completion date in second quarter of 2016.

Table of Contents

**IKONICS CORPORATION**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

*ERP System:*

During the second quarter of 2015, the Company committed to purchase $140,000 of software related to the implementation of a new Enterprise Resource Planning (ERP) system. The new ERP system will better support and accommodate IKONICS operations and replacing the Company s existing ERP system. The total ERP system project is expected to cost approximately $400,000 and is expected to be completed by the second quarter of 2016.

*Line of Credit:*

A bank line of credit exists providing for borrowings of up to $1,250,000 and expires on May 31, 2017. The line of credit is collateralized by the Company s assets and bears interest at 2.5 percentage points over the 30-day LIBOR rate. The Company did not utilize this line of credit during the first six months of 2015 or 2014 and there were no borrowings outstanding as of June 30, 2015 and 2014. There are no financial covenants related to the line of credit. In July 2015, the bank line of credit was increased to $2,050,000 and the interest rate was decreased to 1.8 percentage points over the 30-day LIBOR rate. The bank line of credit expiration date did not change from May 31, 2017.

## 7. Segment Information

The Company s reportable segments are strategic business units that offer different products and have varied customer bases. There are five reportable segments: Domestic, Export, IKONICS Imaging, Digital Texturing (DTX) and Advanced Material Solutions (AMS). Domestic sells screen printing film, emulsions, and inkjet receptive film to distributors located in the United States and Canada. IKONICS Imaging sells photo resistant film, art supplies, glass, metal medium and related abrasive etching equipment to end user customers located in the United States and Canada. AMS provides sound deadening technology to the aerospace industry along with products and services for etched composites, ceramics, glass and silicon wafers. DTX includes products and customers related to patented and proprietary inkjet technology used for mold texturing and prototyping. Export sells primarily the same products as Domestic and the IKONICS Imaging products not related to AMS or DTX. The accounting policies 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, 2014.

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

**For the three months ended June 30, 2015:**

| | Domestic | Export | Imaging | IKONICS DTX | AMS | Unalloc. | Total |
|---|---|---|---|---|---|---|---|
| Net sales | $ 2,111,510 | $ 1,337,121 | $ 991,108 | $ 101,662 | $ 112,147 | $ | $ 4,653,548 |
| Cost of goods sold | 1,207,376 | 1,018,025 | 449,116 | 69,003 | 270,286 | | 3,013,806 |
| Gross profit (loss) | 904,134 | 319,096 | 541,992 | 32,659 | (158,139) | | 1,639,742 |
| Selling general and adminstrative* | 323,730 | 137,271 | 237,167 | 54,711 | 75,557 | 424,085 | 1,252,521 |
| Research and development* | | | | | | 192,539 | 192,539 |
| Income (loss) from operations | $ 580,404 | $ 181,825 | $ 304,825 | $ (22,052) | $ (233,696) | $ (616,624) | $ 194,682 |

Table of Contents

**IKONICS CORPORATION**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

**For the three months ended June 30, 2014:**

| | Domestic | Export | Imaging | IKONICS DTX | AMS | Unalloc. | Total |
|---|---|---|---|---|---|---|---|
| Net sales | $ 2,089,767 | $ 1,626,682 | $ 1,046,592 | $ 94,612 | $ 67,094 | $ | $ 4,924,747 |
| Cost of goods sold | 1,220,452 | 1,194,219 | 510,508 | 84,705 | 203,991 | | 3,213,875 |
| Gross profit (loss) | 869,315 | 432,463 | 536,084 | 9,907 | (136,897) | | 1,710,872 |
| Selling general and adminstrative* | 332,442 | 142,716 | 227,816 | 50,657 | 95,334 | 391,448 | 1,240,413 |
| Research and development* | | | | | | 177,479 | 177,479 |
| Income (loss) from operations | $ 536,873 | $ 289,747 | $ 308,268 | $ (40,750) | $ (232,231) | $ (568,927) | $ 292,980 |

**For the six months ended June 30, 2015:**

| | Domestic | Export | Imaging | IKONICS DTX | AMS | Unalloc. | Total |
|---|---|---|---|---|---|---|---|
| Net sales | $ 3,489,299 | $ 2,455,415 | $ 1,884,873 | $ 197,056 | $ 224,794 | $ | $ 8,251,437 |
| Cost of goods sold | 2,048,332 | 1,902,353 | 909,487 | 142,094 | 508,754 | | 5,511,020 |
| Gross profit (loss) | 1,440,967 | 553,062 | 975,386 | 54,962 | (283,960) | | 2,740,417 |
| Selling general and adminstrative* | 639,897 | 291,991 | 498,423 | 90,243 | 177,659 | 969,905 | 2,668,118 |
| Research and development* | | | | | | 348,383 | 348,383 |
| Income (loss) from operations | $ 801,070 | $ 261,071 | $ 476,963 | $ (35,281) | $ (461,619) | $ (1,318,288) | $ (276,084) |

**For the six months ended June 30, 2014:**

| | Domestic | Export | IKONICS Imaging | DTX | AMS | Unalloc. | Total |
|---|---|---|---|---|---|---|---|
| Net sales | $ 3,599,931 | $ 2,813,394 | $ 2,608,396 | $ 207,129 | $ 160,473 | $ | $ 9,389,323 |
| Cost of goods sold | 2,103,556 | 2,069,119 | 1,166,507 | 164,468 | 415,648 | | 5,919,298 |
| Gross profit (loss) | 1,496,375 | 744,275 | 1,441,889 | 42,661 | (255,175) | | 3,470,025 |
| Selling general and adminstrative* | 628,793 | 266,844 | 472,164 | 85,866 | 207,589 | 879,807 | 2,541,063 |
| Research and development* | | | | | | 320,809 | 320,809 |
| Income (loss) from operations | $ 867,582 | $ 477,431 | $ 969,725 | $ (43,205) | $ (462,764) | $ (1,200,616) | $ 608,153 |

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

Trade receivables by segment as of June 30, 2015 and December 31, 2014 were as follows:

| | June 30, 2015 | Dec 31, 2014 |
|---|---|---|
| Domestic | $ 1,005,847 | $ 1,068,170 |
| Export | 750,167 | 640,464 |
| IKONICS Imaging | 272,551 | 254,483 |
| DTX | 62,285 | 86,507 |
| AMS | 86,743 | 85,170 |
| Unallocated | (22,685) | (38,466) |
| Total | $ 2,154,908 | $ 2,096,328 |

Table of Contents

**IKONICS CORPORATION**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

8. Income Taxes

The Company reports a liability for unrecognized tax benefits taken or expected to be taken when they are uncertain. As of June 30, 2015 and 2014, there was no liability for unrecognized tax benefits.

The Company is subject to taxation in the United States and various states. The material jurisdictions that are subject to examination by tax authorities primarily include Minnesota and the United States, for tax years 2012, 2013, and 2014.

Table of Contents

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, 2014, 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 second quarter of 2015 and for the same period of 2014. 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 market value using the last in, first out (LIFO) method. The Company monitors its inventory for obsolescence and records reductions from cost when required.

*Income Taxes.* Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax 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. 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

Table of Contents

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

(a) persuasive evidence of an arrangement (principally in the form of customer sales orders and the Company s sales invoices)

(b) delivery and performance (evidenced by proof of delivery, e.g. the shipment of film and substrates with bill of lading used for proof of delivery for FOB shipping point terms, and the carrier booking confirmation report used for FOB destination terms). Once the finished product is shipped and physically delivered under the terms of the invoice and sales order, the Company has no additional performance or service obligations to complete

(c) a fixed and determinable sales price (the Company s pricing is established and is not based on variable terms, as evidenced in either the Company s invoices or the limited number of distribution agreements; the Company rarely grants extended payment terms and has no history of concessions)

(d) a reasonable likelihood of payment (the Company s terms are standard, and the Company does not have a substantial history of customer defaults or non-payment)

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

**Results of Operations**

***Quarter Ended June 30, 2015 Compared to Quarter Ended June 30, 2014***

*Sales.* The Company realized a 5.5% sales decrease during the second quarter of 2015 with sales of $4.7 million, compared to $4.9 million in sales during the same period in 2014. Second quarter sales were unfavorably impacted by the weaker European economy and the stronger U.S. dollar as Export sales decreased 17.8% to $1.3 million in the second quarter of 2015 compared to $1.6 million during the same period in 2014. IKONICS Imaging also posted lower sales in the second quarter of 2015 with a 5.3%, or $55,000, sales decrease versus the second quarter of 2014 as glass sales for the quarter lagged behind last year. Partially offsetting these sales decreases was a $45,000, or 67%, AMS sales increase due to growth for both composite machining and industrial masks. Improved emulsion sales resulted in a $22,000, or 1%, Domestic sales increase for the second quarter of 2015 over the same period in 2014 while DTX sales grew by $7,000, or 7.5%, in the second quarter of 2015.

*Gross Profit*. Gross profit was $1.6 million, or 35.2% of sales, in the second quarter of 2015 compared to $1.7 million, or 34.7% of sales, for the same period in 2014. The gross profit as a percentage of sales increased in second quarter of 2015 over the same period in 2014 due to improved sales mix. Both lower margin Export and IKONICS Imaging glass sales comprised a smaller percentage of total sales during the second quarter of 2015 versus

Table of Contents

the second quarter of 2014. However, the lower Export and glass sales volumes negatively impacted overall gross margin dollars.

*Selling, General and Administrative Expenses*. Selling, general and administrative expenses were $1.3 million, or 26.9% of sales, in the second quarter of 2015 compared to $1.2 million, or 25.2% of sales, for the same period in 2014. The slight increase in selling, general and administrative expenses reflects higher travel and trade show expenses for domestic markets in addition to consulting expenses related to the Company s ERP system selection process.

*Research and Development Expenses*. Research and development expenses during the second quarter of 2015 were $193,000, or 4.1% of sales, versus $177,000, or 3.6% of sales, for the same period in 2014. The increase is related to a cost of $46,000 relating to abandonment of patent applications. The Company records patent application costs as an asset and amortizes those costs upon successful completion of the application process or expenses those costs when an application is abandoned.

*Income Taxes.* For the second quarter of 2015, the Company realized income tax expense of $168,000, or an effective rate of 85.9%, versus $96,000, or an effective rate of 32.6% for the second quarter of 2014. The increase in the effective tax rate for the second quarter of 2015 over the second quarter of 2014 is a result of the lower earnings for 2015, causing the non-deductible items to have a more significant rate impact. The income tax provision for the 2015 and 2014 periods also differs from the expected tax expense due to the benefits of the domestic manufacturing deduction and other non-deductible items.

***Six Months Ended June 30, 2015 Compared to the Six Months Ended June 30, 2014***

*Sales.* The Company s sales decreased 12.1% during the first six months of 2015 to $8.3 million versus sales of $9.4 million during the first six months of 2014. Compared to the first half of 2014, IKONICS Imaging sales for the first half of 2015 decreased $724,000. IKONICS Imaging sales in the first six months of 2014 benefitted from a large non-recurring initial stocking order from its new distributor, JDS Industries. Lower IKONICS Imaging equipment and glass sales also contributed to the decrease in first half sales, year over year. Export sales for the first half of 2015 also decreased $358,000, or 12.7%, compared to the same period in 2014 as sales were negatively impacted by the weaker European economy and stronger U.S. dollar. Lower film and emulsion sales in the first half of 2015 resulted in a $111,000 decrease in Domestic sales versus the same period in 2014, while DTX film sales also decreased by $10,000. Partially offsetting these 2015 first half sales decreases versus the same period in 2014, was a $64,000 increase in AMS sales related to both improved mask and composite machining sales.

*Gross Profit*. Gross profit for the first six months of 2015 was $2.7 million, or 33.2% of sales, compared to $3.5 million, or 37.0% of sales, for the same period in 2014. The 2014 first half gross margin percentage benefited from the initial stocking order from JDS Industries. The 2014 JDS Industries initial stocking order was mainly

comprised of film products, which have higher gross margins. Export s 2015 gross margin also was down compared to the same period in 2014 due to a decrease in higher margin sales to Europe. Lower volumes also negatively impacted the Domestic gross margin in the first half of 2015. The DTX gross margin improved in the first half of 2015 compared to the same period in 2014 due to higher 2014 maintenance costs. The 2015 AMS first half gross margin percentage improved over the same period in 2014 due to an increase in volume although the 2015 AMS gross profit in aggregate decreased as a result of higher labor costs. Beginning in the second half of 2016, the Company expects AMS production costs to increase and gross profit in the aggregate to decrease in the short term due to the building expansion to improve AMS production capacity and capabilities.

*Selling, General and Administrative Expenses*. Selling, general and administrative expenses were $2.7 million, or 32.3% of sales, in the first half of 2015 compared to $2.5 million, or 27.1% of sales, for the same period in 2014. The increase in selling, general and administrative expenses reflects higher travel and trade show expenses for both domestic and export markets in addition to consulting expenses related the Company s ERP system selection process and employee training.

Table of Contents

*Research and Development Expenses*. Research and development expenses during the first half of 2015 were $348,000, or 4.2% of sales, versus $321,000, or 3.4% of sales, for the same period in 2014. The increase is related to a cost of $46,000 relating to abandonment of patent applications. The Company records patent application costs as an asset and amortizes those costs upon successful completion of the application process or expenses those costs when an application is abandoned.

*Income Taxes*. For the first six months of 2015, the Company realized an income tax benefit of $72,000, or an effective rate of 26.26%, compared to income tax expense of $208,000, or an effective rate of 34.1%, for the same period in 2014. The Company s income tax benefit for the first half of 2015 was due to the year to date net loss. The income tax provision for 2015 and 2014 differs from the expected tax expense due to the benefits of the domestic manufacturing deduction, other non-deductible items and state income tax.

**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 $2.4 million and $1.9 million at June 30, 2015 and December 31, 2014, respectively. Operating activities provided $469,000 in cash to the Company during the first six months of 2015 compared to $364,000 of cash provided by operating activities during the same period in 2014. Cash provided by operating activities is primarily the result of net income or loss adjusted for non-cash depreciation, amortization, and certain changes in working capital components discussed in the following paragraph.

During the first six months of 2015, the timing of collections resulted in a $59,000 increase 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 decreased by $267,000 due to the timing of raw material purchases and efforts to more tightly manage finished inventory levels. Prepaid expenses and other assets increased $60,000, reflecting insurance premiums paid in advance. Accounts payable increased $225,000 due to the timing of vendor payments. Accrued expenses decreased $18,000, reflecting the timing of compensation payments while income taxes receivable increased $83,000 due to the timing of estimated tax payments and the volume of taxable income.

During the first six months of 2014, increased sales volumes resulted in a $193,000 increase 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 also increased by $76,000 due to the timing of raw material purchases. Prepaid expenses and other assets increased $32,000, reflecting insurance premiums paid in advance in the first six months of 2014. Accounts payable decreased $21,000 due to the timing of vendor payments. Accrued expenses decreased $31,000, reflecting the timing of compensation payments while income taxes receivable increased $33,000 due to the timing of estimated tax payments compared to the calculated 2014 tax liability

During the first six months of 2015, cash used in investing activities was $37,000. Nine certificates of deposits totaling $1.2 million matured during the first half of 2015. The Company purchased three certificates of deposits totaling $650,000. The Company s purchases of property and equipment were $568,000, mainly for upgrades to improve AMS production and process capabilities along with costs associated with mandatory elevator upgrades. Also during the first six months of 2015, the Company incurred $30,000 in patent application costs that the Company records as an asset and amortizes upon successful completion of the application process.

During the first six months of 2014, cash used in investing activities was $984,000. The Company purchased ten certificates of deposits totaling $1.5 million. Six certificates of deposits totaling $959,000 matured during the first half of 2014. The Company s purchases of property and equipment were $403,000, mainly for improvements to AMS equipment, mandatory elevator upgrades, two forklifts and two vehicles. The Company realized $9,000 in proceeds from the sale of two vehicles. Also during the first six months of 2014, the Company

Table of Contents

incurred $39,000 in patent application costs that the Company records as an asset and amortizes upon successful completion of the application process.

During the first six months of 2014, the Company received $45,000 from financing activities from the issuance of 5,916 shares of common stock from the exercise of stock options. There were no exercises of stock options during the first six months of 2015.

A bank line of credit exists providing for borrowings of up to $1,250,000 and expires on May 31, 2017. The line of credit is collateralized by the Company s assets and bears interest at 2.5 percentage points over the 30-day LIBOR rate. The Company did not utilize this line of credit during the first six months of 2015 or 2014 and there were no borrowings outstanding as of June 30, 2015 and 2014. There are no financial covenants related to the line of credit. In July 2015, the bank line of credit was increased to $2,050,000 and the interest rate was decreased to 1.8 percentage points over the 30-day LIBOR rate. The bank line of credit expiration date did not change from May 31, 2017.

The Company believes that current financial resources, its line of credit, 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.

**Capital Expenditures**

Through the first six months of 2015, the Company spent $568,000 on capital expenditures. Capital expenditures during the first six months were mainly for improvements to AMS capabilities and mandatory elevator upgrades. The Company expects total capital expenditures in 2015 of approximately $950,000, excluding building expansion expenditures. Plans for capital expenditures include additional AMS and other production equipment, a new enterprise resource planning system (ERP) to replace the Company s current system, research and development equipment and a vehicle. Additionally, the Company is proceeding with a building expansion to accommodate the growth of its AMS operations. The expansion cost currently is estimated to be approximately $3.5 million, although the expansion cost could vary based on unexpected factors that arise once construction begins. The Company anticipates the amounts for the building expansion will be spent over the remainder of 2015 and the first half of 2016. The Company expects to fund its capital expenditures with existing cash and investments, cash generated from operating activities and utilization of the Company s line of credit. The amount borrowed from the line of credit is not certain and will be dependent on Company s operating results and the timing of cash outlays for these projects.

**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 30% of total sales during the first six months of 2015 and 2014. Although the percent of Export sales to total sales did not change in the first six months of 2015 versus 2014, Export sales volume for the first half of 2015 were down compared to the same period in 2014 due the weaker European economy and stronger U.S. dollar. 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.

The Company s foreign transactions are primarily negotiated, invoiced and paid in U.S. dollars, while a portion is transacted in Euros. IKONICS has not implemented an economic hedging strategy to reduce the risk of foreign currency translation exposures, which management does not believe to be significant based on the scope and geographic diversity of the Company s foreign operations as of June 30, 2015. Furthermore, the impact of foreign exchange on the Company s balance sheet and operating results was not material in either 2015 or 2014.

Table of Contents

**Future Outlook**

IKONICS has spent on average approximately 4% of its sales dollars for the past few years in research and development and has made capital expenditures related to its DTX and AMS programs. The Company plans to maintain its efforts in this area to expedite internal product development as well as to form technological alliances with outside experts to commercialize new product opportunities.

The Company continues to make progress on its AMS business initiative. The Company has entered into agreements with major aerospace companies and smaller programs to determine the feasibility of using its unique technologies in the production of military and commercial aircraft. Progress is being made on a number of these in-house feasibility projects, and the Company believes that several of these could lead to ongoing business. In anticipation of this business, the Company is expanding its AMS capacity and patent applications.

The Company is also continuing to make progress on its DTX business initiatives. In addition to its growing inkjet technology business, the Company offers a range of products for creating texture surfaces and has introduced a fluid for use in prototyping. The Company is currently working on production improvements to enhance its customer offerings. The Company has been awarded European, Japanese and United States patents on its DTX technologies. The Company has modified its DTX technology to enter the market for prototyping and 3D printing.

Domestically, both the Domestic and IKONICS Imaging units remain profitable in mature markets and require aggressive strategies to grow market share. Although there will be challenges, the Company believes these businesses will continue to grow and prosper. 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 made this more challenging in the first half of 2015, and the Company anticipates continued strength of the U.S. dollar in the near term.

In addition to the $3.5 million building expansion to accommodate the AMS division and the implementation of the a new ERP system, other future activities undertaken to expand the Company s business may include acquisitions, building improvements, equipment additions, new product development and marketing opportunities.

**Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2014-09, *Revenue from Contracts with Customers.* ASU 2014-09 supersedes the revenue recognition requirements in *Revenue Recognition (Topic 605*), and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for the Company in its fiscal year beginning on January 1, 2017, including interim periods within that reporting period and is to be applied retrospectively, with early application not permitted. The Company is currently evaluating the effect that adopting this new accounting guidance will have on its consolidated results of operations, cash flows and financial position.

In April 2015, the FASB issued ASU No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. ASU 2015-03 amends existing guidance to require the presentation of debt issuance costs in the balance sheet as a deduction from the carrying amount of the related debt liability instead of a deferred charge. It is effective for annual reporting periods beginning after December 15, 2015, but early adoption is permitted. The Company does not expect the provision of ASU 2015-03 to have a material impact on its consolidated financial statements.

**Off Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements.

Table of Contents

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

Table of Contents

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**

Not applicable

**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 June 30, 2015:

| Exhibit | Description |
|---|---|
| 3.1 | Restated Articles of Incorporation of Company, as amended.(1) |
| 3.2 | By-Laws of the Company, as amended.(2) |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certifications of CEO |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certifications of CFO |
| 32 | Section 1350 Certifications |
| 101 | Interactive Data Files Pursuant to Rule 405 of Regulation S-T |

Copies of Exhibits will be furnished upon request and payment of the Company s reasonable expenses in furnishing the Exhibits.

(1) Incorporated by reference to the like numbered Exhibit to the Company s Registration Statement on Form 10-SB (File No. 000-25727).

(2) Incorporated by reference to the like numbered Exhibit to the Company s Current Report on Form 8-K filed with the Commission on February 22, 2007 (File No. 000-25727).

Table of Contents

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: August 13, 2015

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

Table of Contents

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