# ISOMET CORPORATION

# 2017 ANNUAL REPORT

To Shareholders and Employees,

Our modest increase in revenues and substantial reduction in losses reflected the improving market conditions throughout 2017. The fourth quarter was especially intense with short cycle demands from industrial laser manufacturers. With small size comes flexibility and customer service. Team Isomet responded and we picked up several significant new OEM partners. Despite the late flurry, we missed our internal goal of returning the company to profitability within the year. A major influence on this was the Board's decision in 2016 to relocate the company. This has inevitably resulted in some disruption and impacted production. However, the move is a key element in our long-term business plan to meet the challenges ahead: overhead reduction, staff recruitment, operational efficiency. The relocation was initiated in the latter part of 2017 and the physical move started during the first quarter of 2018. It will remain disruptive on operations until second quarter of 2018.

I firmly believe that innovation breeds success. We are working closely with global high-tech companies to develop custom high-speed laser beam deflection solutions for ultra-precision laser material process applications. These programs are progressing well. The financial benefits will not be immediate, but the medium-term rewards are promising indeed.

None of this is possible without the hard work and dedication of all our staff.

Thank you. An exciting 2018 awaits.

Michael Hillier
President

# ISOMET CORPORATION

## CONSOLIDATED BALANCE SHEET

| | As of December 31, 2017 | 2016 |
|---|---|---|
| ASSETS | | |
| Cash and Investments | $ 256,261 | $ 165,501 |
| Accounts Receivable | 272,293 | 137,202 |
| Other Assets | 53,699 | 59,898 |
| Precious Metals | 190,688 | 180,522 |
| Inventories | 2,672,064 | 2,533,543 |
| Total Current Assets | 3,445,005 | 3,076,666 |
| Net Fixed Assets | 583,106 | 516,760 |
| Total Assets | $ 4,028,111 | $ 3,593,426 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Notes Payable | $ 1,480,000 | $ 1,480,000 |
| Accounts Payable | 237,257 | 132,651 |
| Accrued Liabilities | 981,702 | 744,904 |
| Customer Advances | 255,683 | 128,614 |
| Total Liabilities | 2,954,641 | 2,486,168 |
| Stockholders' Equity | | |
| Common Stock | 2,103,090 | 2,103,090 |
| Paid-in Capital | 4,349,243 | 4,349,243 |
| Accumulated Deficit | (5,326,820) | (5,254,823) |
| Foreign Exchange Adjustment | (52,043) | (90,252) |
| Total Stockholders' Equity | 1,073,470 | 1,107,258 |
| Total Liabilities and Stockholders' Equtiy | $ 4,028,111 | $ 3,593,426 |

This statement is unaudited.

# ISOMET CORPORATION

CONSOLIDATED STATEMENT OF EARNINGS

Year Ended December 31,

| | 2017 | 2016 |
|---|---|---|
| Revenue | | |
| Sales | $ 3,363,573 | $ 2,788,161 |
| Interest | 3 | 9 |
| Other Income | - | - |
| Total | 3,363,576 | 2,788,170 |
| Expenses | | |
| Cost of Sales | 2,076,224 | 1,723,641 |
| Selling Expenses | 82,254 | 103,987 |
| General Administrative | 1,157,492 | 1,162,790 |
| Interest Expense | 119,604 | 119,600 |
| Total | 3,435,572 | 3,110,017 |
| Income (Loss) Before Taxes | (71,996) | (321,848) |
| Benefit (Charges) Equivalent to Return of Income Taxes | - | - |
| Net Income (Loss) | $ (71,996) | $ (321,848) |
| Weighted Number of Shares Outstanding | 2,103,090 | 2,103,090 |
| Basic Net Income (Loss) Per Share | $ (0.03) | $ (0.15) |

This statement is unaudited.

## 1. Organization and significant accounting policies

**Organization:** Isomet Corporation and its Subsidiary (the Company) produce and sell laser equipment, systems and laser accessory components for laser-based applications.

**Basis of consolidation**: The Company has a wholly-owned subsidiary in the United Kingdom. The consolidated financial statements include the accounts of Isomet and its subsidiary. All material intercompany accounts and transactions have been eliminated in consolidation.

**Revenue recognition**: The Company recognizes revenue at the time goods are shipped and title passes to the customer, including goods shipped under multiple delivery fixed-price contracts. The Company's only obligation after goods are shipped is a one-year warranty. The Company's experience has been that subsequent warranty costs are not significant, and the Company expenses these costs as they are incurred.

**Inventories**: Inventories of parts are stated at cost determined on a first-in, first-out basis, which does not exceed market. Work-in process and finished goods are stated at the lower of standard costs (which approximate average costs) or market.

**Precious metals**: The Company's manufacturing processes includes the growth of crystals that are subsequently fabricated and used in laser beam modulation. The growth of the crystals in a laboratory environment requires the use of containers, wire and parts that can withstand extremely high temperatures or have high conductivity characteristics. These materials are the precious metals reported on the balance sheet and are reported at market price based on quoted prices at year end as provided by the Company's principal suppliers.

**Property and equipment**: Depreciation and amortization of property and equipment is recorded using the straight-line method over estimated useful lives as follows:

| | |
|---|---|
| Equipment and furniture | 10 years |
| Vehicles | 3-5 years |
| Leasehold improvements | Remaining term of lease |

Property and equipment represent the Company's only long-lived assets.

**Foreign currency translation:** The assets and liabilities of the Company's foreign operations are translated at rates of exchange in effect at year end, and revenue, expenses, gains and losses are translated at the average rates of exchange for the year. Gains and losses from translation are accumulated as a separate component of stockholders' equity until the foreign entity is sold or liquidated.

**Financial statement estimates:** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Financial condition:** The Company incurred losses from operations from 2001 through 2009 of approximately $5,500,000 due primarily to a weak economy for new technology equipment. The Company adjusted its operations in response to these conditions by implementing cost containment plans to enhance products and acquiring new customers.

While operating at below breakeven levels for much of that time, the Company met its cash requirements through recoveries of income taxes paid in prior years, renegotiation of the terms of certain debt to extend its maturity, obtaining new debt through convertible notes in 2004 and 2005 and obtaining new debt from its president in 2005. In January 2006, the president of the Company died, and the life insurance proceeds collected were used to repay the revolving credit facility in full. During 2007, 2008 and 2009, management continued to cut costs, allowing the Company to operate at a breakeven level. Improvement in the world economy brought increased sales and resulting profits beginning in 2010. During 2016. The Corporation experienced a reduction in sales that was met with a reduction in payroll costs and a planned move to significantly less expensive location. Based on the results of 2017, it is management's opinion that the company is returning to a profitable position

**Audited Financial Statements:** It has been the practice of the Company to have an outside accounting firm audit the Company's financial statements on an annual basis. Due to timing complications and cash flow shortage at the end of 2007 and continuing cash flow concerns in subsequent years, the Company did not undergo formal audits. However, the Company's subsidiary in the United Kingdom has been audited for every year from 2007 through 2017 as required by law in that jurisdiction. One third of the consolidated revenue of the Company is generated by that subsidiary.

For the year ended December 31, 2006, the Company's independent auditor's opinion letter expressed doubt about the Company's ability to continue as a going concern. An independent auditor would have continued to express that concern for the years ending December 31, 2007 and December 31, 2008. For the year ending December 31, 2009, that doubt would have been diminished. For the years ended December 31, 2010 and thereafter, management believes an outside auditor would have dropped that concern.

## 2. Notes payable

Notes payable consist of the following at December 31, 2017:

| | |
|---|---|
| Notes payable – Convertible into shares of the Company's common stock at a rate of $1.60 per share and are subordinated to other indebtedness of the Company, as defined. The notes were due on June 30, 2009. | $ 750,000 |
| Note payable – Convertible into shares of the Company's common stock at a rate of $1.60 per share and is subordinated to other indebtedness of the Company, as defined. The note was due on February 20, 2011. | $ 370,000 |
| Note payable – Non-convertible bridge loan. The note is secured by all the assets of the Company. The note was due on December 31, 2015. | $ 300,000 |
| Note payable – Line of Credit Promissory Note The note is secured by all the assets of the Company. The note was due on December 31, 2016. | $ 60,000 |
| Total | $ 1,480,000 |

## 3. Income taxes

The Company has domestic net operating loss carry forwards in excess of $8,000,000 that may be used to offset future taxable income. The net operating loss carry forwards begin to expire in 2023. Foreign (United Kingdom) net operating loss carry forwards remaining from prior years were used in full during 2008.

## 4. Lease Commitments

In the United States, the manufacturing facility and offices have been moved to a new location with significantly lower occupancy costs. The new building is leased through November 30, 2027. In the United Kingdom, the manufacturing facility and offices are leased through December 15, 2018. Management is satisfied with the location. Lease renewal negotiation is under way.

## 5. Retirement plans

The Company's U.K. subsidiary maintains a defined contribution retirement plan which is available to all employees of the subsidiary. The plan is funded through the purchase of a group annuity insurance policy. Employer contributions are discretionary. Employees may contribute to the plan in an amount that does not exceed 15% of the employee's annual compensation and vest 100% in their own contributions. Vesting in the employer contributions does not occur until the employee's normal retirement date, as defined. The plan is cancelable upon 30 days notice.

The Company maintains a contributory plan pursuant to Section 401(k) of the Internal Revenue Code. The plan is available to all employees of the parent company who have completed one year of service. Participants may elect to contributions to the Plan in an amount not to exceed the maximum amounts specified by law. The Company matches employee contributions in an amount not to exceed 2% of annual compensation. The Company may make additional contributions at its discretion. Participants are vested 100% in their contributions. Vesting in employer contributions is 20% per year with 100% vesting after five years.