ISOMET CORPORATION

2016 ANNUAL REPORT

To Shareholders and Employees:

Against the backdrop of uncertainty fuelled by Brexit and the US Presidential election, 2016 proved to be a very difficult trading year for Isomet. This is our first reported loss since 2009. Revenue was down by 30% resulting in a loss of $321,848.

All the expected major OEM contracts, due in the latter half of 2016, did not materialize. However, these were postponed rather than cancelled or lost to our competition. I am now pleased to report a number are active and preliminary orders have been received.

Product development continued despite limited resources, focused on devices with the greatest market potential. This includes the iMS4 range of computer controlled frequency synthesizers, programming tools and operating software. In combination, this package offers a simple route to integrate our AO scanners into complex laser scanning systems and shorten the customers overall design time. The iMS4 has attracted interest from significant clients and is to be used in several pilot projects with strong volume potential forecast for 2017-18.

A drive to improve sales across non-industrial sectors resulted in a 50% increase in the number of AO modulators shipped in 2016 to scientific, metrology and research customers. However, this did not make up for the 65% shortfall in high power industrial devices that, in general, command a higher unit price. We have weathered this storm through the determination and dedication of all staff members from the top down. Sacrifices were endured resulting in a 20% reduction in payroll costs alone. All fixed costs were scrutinized. A major item is rent for the Springfield premises, home of Isomet Corporation since 1979. This lease expires in 2017 and a decision has been made to relocate within Virginia, farther away from the costly downtown of Washington, DC.

The move offers a number of additional benefits. The proposed building is well suited to high tech, clean, manufacturing environment and allows work flow efficiency improvements to be effectively implemented. The lower cost community is more attractive from both staff retention and staff recruitment perspectives. Relocation is not without risk but is manageable. Commissioning relatively old, bespoke vacuum equipment will be a challenge as will be minimizing production downtime over the move period, particularly as we now experience a welcome and significant increase in business activity.

There is little doubt that 2017 will be an eventful year. The planned move is the first step in laying a new foundation for Isomet and is fundamental for our regeneration.
I would like to take this opportunity to thank the entire Isomet team for their understanding and hard work throughout a difficult 2016 and look forward to their support in meeting the challenges of 2017.

Michael Hillier
President

ISOMET CORPORATION
CONSOLIDATED BALANCE SHEET

	As of December 31, 2016	2015
ASSETS		
Cash and Investments	$ 165,501	$ 101,185
Accounts Receivable	137,202	272,040
Other Assets	59,898	68,941
Precious Metals	180,522	179,204
Inventories	2,533,543	2,541,891
Total Current Assets	3,076,666	3,163,261
Net Fixed Assets	516,760	646,219
Total Assets	$ 3,593,426	$ 3,809,481
LIABILITIES AND STOCKHOLDERS' EQUITY		
Notes Payable	$ 1,480,000	$ 1,420,000
Accounts Payable	132,651	156,208
Accrued Liabilities	744,904	507,544
Customer Advances	128,614	182,740
Total Liabilities	2,486,168	2,266,492
Stockholders' Equity		
Common Stock	2,103,090	2,103,090
Paid-in Capital	4,349,243	4,349,243
Accumulated Deficit	(5,254,823)	(4,932,974)
Foreign Exchange Adjustment	(90,252)	23,631
Total Stockholders' Equity	1,107,258	1,542,989
Total Liabilities and Stockholders' Equtiy	$ 3,593,426	$ 3,809,481

This statement is unaudited.

ISOMET CORPORATION

CONSOLIDATED STATEMENT OF EARNINGS

Year Ended December 31,

	2016	2015
Revenue		
Sales	$ 2,788,161	$ 3,969,942
Interest	9	11
Other Income	-	-
Total	2,788,170	3,969,954
Expenses		
Cost of Sales	1,723,641	2,517,400
Selling Expenses	103,987	191,942
General Administrative	1,162,790	1,059,794
Interest Expense	119,600	124,437
Total	3,110,017	3,893,572
Income (Loss) Before Taxes	(321,848)	76,382
Benefit (Charges) Equivalent to Return of Income Taxes	-	-
Net Income (Loss)	$ (321,848)	$ 76,382
Weighted Number of Shares Outstanding	2,103,090	2,103,090
Basic Net Income (Loss) Per Share	$ (0.15)	$ 0.04

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 enhancing 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 has been met with a reduction in payroll costs and a planned move to significantly less expensive location. 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 2015 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, 2013:

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 of 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 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 are leased through May 31, 2017. The Company has been a tenant at its current location since 1979. The company plans to relocate to a nearby community with lower occupancy costs.

In the United Kingdom, the manufacturing facility and offices are leased through December 15, 2018.

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.